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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED FUEL GAS COMPANY,
Appellant,

—against—

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

JURISDICTIONAL STATEMENT

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October 8, 1963.

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Appellee.

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

JURISDICTIONAL STATEMENT

Appellant appeals from a judgment of the Supreme Court of Appeals of the State of West Virginia entered on May 20, 1963, and amended on May 29, 1963, denying a petition for review of final orders of the Public Service Commission of West Virginia, and submits this Statement to show that the Supreme Court of the United States has jurisdiction of the appeal and that substantial questions are presented.

OPINIONS BELOW

The court below did not enter an opinion but, by amendment to its final judgment, certified that it had maturely considered the record, including the federal questions raised.

This certificate as well as the final judgment of the court below are attached hereto as Appendix A. The majority and dissenting opinions, reported at 46 P. U. R. 3d 118 (1962), and the orders, of the Public Service Commission of West Virginia are attached hereto as Appendix B.

JURISDICTION

This proceeding was brought under Section 2577 of the West Virginia Code of 1961 (Michie's) to set aside final orders of the Public Service Commission of West Virginia. Those orders were issued pursuant to Sections 2553-2556 of the West Virginia Code empowering the Public Service Commission of West Virginia to regulate public utilities and to set their intrastate rates. The judgment of the Supreme Court of Appeals of West Virginia, denying review, was entered on May 20, 1963, amended on May 29, 1963, and notice of this appeal was filed in that court on August 15, 1963. The jurisdiction of this Court to review the judgment below is conferred by 28 U. S. C. § 1257(2). The following decisions sustain the jurisdiction of the Court to review on appeal the judgment below: *Northern Natural Gas Co.* v. *Kansas Commission*, 372 U. S. 84; *Atchison, Topeka & Santa Fe Ry.* v. *Public Utilities Commission of California*, 346 U. S. 346; *Dahnke-Walker Milling Co.* v. *Bondurant*, 257 U. S. 282.

QUESTIONS PRESENTED

1. Whether the orders of a state agency, issued pursuant to statutory authority enabling the agency to set intrastate retail rates for natural gas companies, are repugnant to the Supremacy Clause, the Commerce Clause, and the Due Process Clause of the Constitution, and to the Natural Gas Act, in so far as such orders are in direct con-

flict with a determination by the Federal Power Commission regarding the classification of the same costs, as between demand and commodity costs, of a natural gas company, ninety-two per cent of whose annual sales and eighty-seven per cent of whose winter peak sales are in interstate commerce.

2. Whether such orders are repugnant to Section 167 of the Internal Revenue Code in so far as they provide a reduced allowance for federal income tax expense as if, contrary to the fact, the natural gas company had elected to use the so-called Guideline Procedures to effect more rapid depreciation for federal income tax purposes.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The constitutional provisions and statutes involved are the Supremacy Clause, U. S. Const. Art. VI, the Commerce Clause, U. S. Const. Art. I § 8, and the Due Process Clause, U. S. Const. Amend. XIV § 1, Sections 4 and 7 of the Natural Gas Act, 52 Stat. 822, 824 (1958), 15 U. S. C. §§ 717c, 717f (1958), Section 167 of the Internal Revenue Code of 1954, and Sections 2553-2556 and 2577 of the West Virginia Code of 1961 (Michie's). The West Virginia statutes, Sections 4 and 7 of the Natural Gas Act, Section 167 of the Internal Revenue Code, and excerpts from the Depreciation Guidelines and Rules, Rev. Proc. 62-21, Treas. Pub. No. 456 (1962), are set forth in Appendix C hereto.

STATEMENT

Appellant is an integrated natural gas company, approximately ninety-two per cent of whose annual sales and eighty-seven per cent of whose winter peak sales are in inter-

state commerce subject to the jurisdiction of the Federal Power Commission, and eight per cent of whose annual sales and thirteen per cent of whose winter peak sales are in intrastate commerce in West Virginia subject to the jurisdiction of the Public Service Commission of that State. The bulk of appellant's business consists of supplying gas for resale in interstate commerce to gas distribution companies and the bulk of its supply of gas originates in the southwest and is purchased from, or transported by, other natural gas companies regulated by the Federal Power Commission. In addition, a small portion of appellant's business is in intrastate commerce, consisting of sales of natural gas to retail customers principally located in West Virginia and, to a minor extent, outside West Virginia.* More than eighty per cent of appellant's gas supply for these retail sales comes from the southwest and is purchased, or transported, at rates fixed by the Federal Power Commission under Section 4 of the Natural Gas Act (App. B, pp. 7b, 8b).

Because of the wide fluctuation, both seasonal and daily, in customers' consumption of gas, it is basic to rate making in the natural gas industry that costs be classified as between "commodity" costs, that is, costs incurred in supplying customers' annual volumetric requirements, and "demand" costs, that is, costs incurred to meet customers' winter peak demands. The natural gas company's great investment in facilities is used to the fullest extent only on days of peak demand but, in order to have the necessary capacity available, the company must incur certain fixed costs the year-round regardless of fluctuations in utilization. Obviously the

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*Appellant's minor non-West Virginia retail sales, which have a de minimis effect on this case, have, for the sake of simplicity, been ignored in this statement and in various of the arithmetic illustrations used herein. Similarly, decimals have been rounded off.

costs attributable to a given class of customers must be determined, not only by the annual volumes delivered to it, but also by the capacity held in readiness for its winter peak requirements. The division of costs into demand and commodity components recognizes this economic reality. Allocations to the demand component of the cost of service are necessary to recoup the costs of maintaining a system capacity available to meet peaks, especially winter peaks resulting from space heating; allocations to the commodity component are necessary to recoup the costs which are a function of the number of cubic feet of gas delivered annually.

The Federal Power Commission has determined, and the West Virginia Commission agrees, that West Virginia retail customers annually consume approximately eight per cent of appellant's volumes of gas delivered but that, because such local consumption is at a poorer load factor* than that enjoyed (by virtue of investment in peak-shaving facilities and the like) by appellant's interstate customers, the West Virginia customers account for thirteen per cent of the demand on appellant's facilities and that such retail customers should bear correlative proportions of appellant's demand and commodity costs (App. B, pp. 11b, 26b).

Eighty per cent of the gas consumed by West Virginia customers originates in the southwest. Some of this southwest gas is purchased by appellant for delivery in the Appalachian area from a southwest pipeline company and the remainder is purchased by appellant in the southwest and transported to the Appalachian area for appellant's account

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*Load factor is the ratio of average daily requirements during a specified time to the peak day's requirements during that time. Where a buyer purchases the same amount on each and every day during the specified time, he is said to have purchased at 100% load factor. Where the buyer's daily purchases over such specified period of time amount, on an average, to only one-half of the buyer's peak day requirements, he is said to have purchased at 50% load factor

by Columbia Gulf Transmission Company, an affiliated company, pursuant to long-term contract. Columbia Gulf's transportation activities make it a natural gas company within the meaning of the Natural Gas Act and its charges to appellant for such transportation services (and the structure of those charges) are determined by the Federal Power Commission under the Act. Appellant's own interstate rates, approved as just and reasonable under the Natural Gas Act, allocate the amounts appellant pays Columbia Gulf, fifty per cent to the demand component of appellant's wholesale rates and fifty per cent to the commodity component (App. B, pp. 11b, 12b, 25b).

The Public Service Commission of West Virginia, on the other hand, noted the action of the Federal Power Commission but, with respect to the intrastate sales subject to its jurisdiction, nevertheless classified appellant's expense for Columbia Gulf transportation service entirely to commodity costs. Since, so far as the Federal Power Commission is concerned, appellant must recoup thirteen per cent of its demand costs and eight per cent of its commodity costs from retail sales made in West Virginia, the conflict between the determinations of the two agencies as to the classification of the charges appellant must pay Columbia Gulf results in an absolute inability to recover one hundred per cent of its costs. The Federal Power Commission's allocation of the interstate transportation charges fifty-fifty between demand and commodity and West Virginia's allocation entirely to commodity means that of every dollar of such charges (i) interstate rates recoup eighty-nine and one-half cents (eighty-seven per cent of fifty cents plus ninety-two per cent of fifty cents) and (ii) West Virginia rates recoup eight cents (thirteen per cent of zero plus eight per cent of one dollar), *leaving two and one-half cents unrecouped*. This amounts to an actual out-of-pocket loss of al-

most 800,000 dollars per year (by appellant's calculation) of the federally required charges paid to Columbia Gulf (App. B, pp. 11b, 12b, 25b-28b).

The other feature of the orders of the Public Service Commission of West Virginia which is complained of here concerns the so-called Guideline Procedures promulgated by the Treasury under Section 167 of the Internal Revenue Code of 1954, which procedures instituted a more liberalized approach to depreciation in terms of the assumed useful lives of property items, solely at the option of the taxpayer.

At the time of the hearing before the West Virginia Commission, appellant stated that the subject of adopting Guidelines with respect to the useful life of its property was under consideration but that to date it had not chosen to exercise the option granted by Congress. The West Virginia Commission, nevertheless, treated appellant's tax expense as if it had been computed by following the Guidelines with the concomitant lower tax. Since appellant had not, in fact, elected to pay federal taxes on this basis, the determination of the West Virginia Commission effectively forces appellant to exercise the federally created option or else suffer in its "cost of service", so far as West Virginia rates are concerned, an income tax expense allowance considerably lower than the income tax expense actually incurred (App. B, pp. 15b, 16b, 28b, 29b).

How the Federal Questions are Presented

The conflict between the orders of the Public Service Commission of West Virginia and those of the Federal Power Commission, and between the former and the Natural Gas Act and Section 167 of the Internal Revenue Code, was recognized by Commissioner Townsend, dissenting from the report of the West Virginia Commission (46 P. U. R. 3d at 131; App. B, p. 23b). The chal-

lenge to the orders on the basis of repugnancy to federal law had been made in the brief, hearing, and petition for rehearing before the West Virginia Commission and was renewed in the court below in appellant's petition for review (R. 1445-48). The court below sustained the validity of the orders drawn in question without opinion but, by amendment to its final judgment, noted that it had maturely considered the record as well as "all of the questions grounded on the Constitution of the United States." (R. 1622; App. A, pp. 2a, 3a).

THE QUESTIONS ARE SUBSTANTIAL

The orders of the West Virginia Commission reflect an attempt to favor the consumers of one state at the expense of interstate commerce (and, therefore, the consumers of other states) by means of a substantial impingement upon a federally preempted segment of natural gas regulation. They also demonstrate an attempt, by a state agency, to exploit federal tax legislation in a manner that is violative of the very provisions of that legislation and antithetical to its purpose.

1. Involved here is a subtle but nonetheless significant imposition of state regulation over the fixing of interstate rates of a natural gas company and the utilization of interstate facilities by such company. It requires little sophistication to know that rate accounting is essential to the federal scheme of natural gas regulation. It has been equally axiomatic that there be an allocation in this accounting process between demand and commodity costs. The demand-commodity allocation principle is long recognized and has been approved by the Court. See *Colorado Interstate Gas Co. v. Federal Power Commission*, 324 U. S. 581

The allocation issue does not involve any dispute as to the total amount of dollars which appellant is *entitled* to recover with respect to the Columbia Gulf transportation charges. The underlying question is what portion of this undisputed dollar total should appellant recover from its interstate sales and what portion from its West Virginia retail sales. There is no dispute that *in toto* it should recover one hundred per cent of its costs. There is no dispute that the apportionment between interstate and intrastate sales should be governed by two factors, (1) the respective peak requirements and (2) the respective annual volume sales, or, in other words, that total demand costs in the cost of service—the cost of meeting peak requirements—should be apportioned on the basis of the interstate and intrastate peak requirements and that the total variable or commodity costs should be apportioned on the basis of the annual volumes sold, interstate and intrastate.

But the dollar result of the apportionment will depend on a further question: what costs *are* demand costs and what costs *are* commodity costs. Since appellant's intrastate *annual volume sales* are a lesser proportion of its total annual volume sales than its intrastate *peak day sales* are of its total peak day sales, the more costs which the West Virginia Commission can allocate to commodity (rather than demand) the more the apportionment of total costs will favor the intrastate West Virginia customers.

The particular item of cost on which this issue focuses is the cost incurred by appellant to transport gas owned by it from Louisiana to West Virginia. Appellant purchases this gas in Louisiana from Louisiana producers and it pays Columbia Gulf for its transportation. This transportation service brings gas which appellant will sell to interstate and intrastate customers. This gas is a single stream, and the joint transportation cost must, accordingly, be apportioned.

This is a long interstate transportation, 800 or 900 miles, across the states of Louisiana, Mississippi, Tennessee and Kentucky to West Virginia. The costs inherent in long line transportation, with the high fixed investment in pipelines, compressor stations and communication facilities, present an almost classic example of costs which do not vary with the volumes of gas transported—costs which are in their nature "demand" costs.

The West Virginia Commission says that these transportation costs are to be classified one hundred per cent to commodity. Its stated reason is that since appellant makes efficient use, at high load factor, of the transportation facilities which involve such fixed costs, they are therefore not to be treated as fixed costs. The Commission says:

> "The function of the transportation of gas by Columbia Gulf is precisely the same as the function of gas purchased in Louisiana. *Only the location of the gas is changed.* The time of its availability remains the same." (Emphasis supplied: App. B, p. 12b.)

The reasons the West Virginia Commission gives for thus tilting the allocation in favor of West Virginia intrastate business seem almost frivolous—but the issue here does not turn on the frivolity of the West Virginia Commission's reasons. It turns on the direct collision here between state law and federal law. The West Virginia Commission says that a cost incurred by appellant (the cost of transporting its gas from Louisiana to West Virginia) must be apportioned as between appellant's interstate and intrastate businesses in a manner different from that which the Federal Power Commission and federal law says that *that very cost* much be apportioned. We are not dealing with a state commission treating an item of cost in a different manner from the manner in which the

federal commission would have treated it. We are here faced with federal and state commissions wrestling with one and the same thing. There is a direct collision as to the identical subject matter.

In disregarding the Federal Power Commission's classification with respect to the Columbia Gulf transportation charges and in computing the West Virginia portion of such expense upon a commodity basis, the West Virginia Commission not only imposes upon appellant a considerable out-of-pocket loss but also a dilemma strikingly similar to that condemned in *Northern Natural Gas Co.* v. *Kansas Commission*, 372 U. S. 84.

Appellant obviously must take some action in the face of a decision that prevents its recoupment of a sizable portion of its expense, which, because of the prior Federal Power Commission's determination, must be recovered from West Virginia sales. The entire pattern of appellant's wholesale purchases of southwest gas, of transportation services with respect to southwest gas, and of utilization of southwest gas in supplying market requirements in the Appalachian area has been certificated by the Federal Power Commission under Section 7 of the Natural Gas Act, 52 Stat. 824 (1938), 15 U. S. C. § 717f (1958), as in the public convenience and necessity. To continue these federally established patterns in the face of the orders appealed from would require appellant to absorb that portion of the amounts it must pay to Columbia Gulf—and Columbia Gulf must charge appellant, all as provided for by Section 4 of the Natural Gas Act, 52 Stat. 822 (1938), 15 U. S. C. § 717c (1958)—which, by virtue of the incompatibility of the Federal Power Commission and West Virginia Commission cost allocations and classifications, it is unable to recoup either from its federally regulated rates to its wholesale customers or from its state regulated rates to its West

Virginia retail customers. Thus caught between inconsistent federal and state regulation of the same subject matter (and assuming that it is neither realistic nor desirable to expect appellant to continue to absorb the amounts in question to the eventual impairment of its ability to serve federally protected consumers and to raise capital to meet their growing requirements at reasonable costs), appellant's only recourse, unless relieved from the orders appealed from, is to seek to change the Federal Power Commission's scheme of cost allocation, facility utilization, gas supply, and gas marketing.

Admittedly, the Federal Power Commission is not bound by the West Virginia cost classification of the charges in question and would not be bound to approve distortions of appellant's interstate system because of the problem presented by the orders below. But to recognize that the Federal Power Commission is free to act is not to say that its regulatory tasks will not be compounded or that the ultimate impact of the conflict in classifications will not tend to frustrate the regulatory scheme.

Appellant's immediate dilemma, a choice between efforts to disrupt its interstate operations (which, as presently constituted, have received the imprimatur of the Federal Power Commission) and acquiescence in a substantial annual loss attributable to the marginal portion of its business in West Virginia, is a dilemma that ought not be countenanced. Clearly, the orders here represent as much of an indirect regulation of interstate wholesalers of natural gas as those involved in *Northern Gas, supra*. *Cf. Cities Service Gas Co.* v. *Kansas Commission*, 355 U. S. 391; *Natural Gas Pipeline Co.* v. *Panoma Corp.*, 349 U. S. 44. Indeed, the collision between the federal and state regulation is inevitable and manifest from the outset, not just a strong possibility as in *Northern Gas*. By directly contradicting the federally ap-

plied demand-commodity allocation, the orders of the West Virginia Commission impair the "ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was the objective of the Natural Gas Act". *Northern Gas*, 372 U. S. at 91-92. As such, they are in violation of Sections 4 and 7 of the Natural Gas Act and, by invading the field which that Act has occupied, cannot stand under the Supremacy Clause.*

Under the Supremacy Clause a state commission surely could not disallow from a local distributing utility's "cost of service" amounts it paid to interstate pipelines for its gas supplies at rates fixed by the Federal Power Commission on the ground that such rates were improper or that such expenses were improvidently incurred. Similarly, the attribution of costs for rate purposes arising out of interstate sales and transportation, where those costs are a large element of the natural gas company's intrastate total and as to which the Federal Power Commission has already spoken, is a subject admitting only of national regulation in the sense of *Cooley* v. *Board of Port Wardens*, 12 How. 299, 319-20, and, more recently, *Florida Avocado Growers* v. *Paul*, 373 U. S. 132, 143-45. Nor is there any gap within the meaning of *Phillips Petroleum Co.* v. *Wisconsin*, 347 U. S. 672, left unfilled by rejection of the state agency's

*The statutory authority for the orders attacked must necessarily come under the same attack because of the nature of its application to the present case. Interestingly, Section 2554 of the West Virginia Code of 1961 (Michie's), dealing with the general power of the Public Service Commission to regulate public utilities, enables the Commission to change any intrastate rate, charge, or toll which is unjust and unreasonable or any interstate charge concerning "matters of a purely local nature which have not been regulated by or pursuant to Act of Congress. . . ." (App. C, pp. 25c, 26c).

determination. This is not an area of interstitial regulation, because the Federal Power Commission has already acted. And it is not a case of federal over-reaching because the state agency is not prevented from determining appellant's retail "cost of service". In such determination, however, it must yield to the prior decision and over-all superintendence of the federal agency as to items governed by the Natural Gas Act.

Quite apart from the lack of rudimentary fairness attending the disparate cost allocations of the same item by the Federal Power Commission and the West Virginia Commission (an unfairness which ought not be a consequence of our federal system), appellant contends in any event that the state determination must be subordinated to the federal. *Northern Gas, supra* at 193; *Hines* v. *Davidowitz*, 312 U. S. 52, 67. See also the statement of Mr. Justice White, dissenting in *Florida Avocado Growers* v. *Paul, supra*:

> ". . . These two regulatory schemes have precisely the same purpose, which is purely an economic one; they seek to achieve it, however, by applying different tests to the same avocados." 373 U. S. at 169.

Although the action of the state agency may appear at first blush to be only of a local character, it must be apparent upon examination that the cause and effect relationship of this intrastate allocation of costs upon interstate commerce and the entire regulatory system envisioned by the Natural Gas Act is inevitable and stark. It was just such a cause and effect that was assailed in *Interstate Natural Gas Co.* v. *Federal Power Commission*, 331 U. S. 682, 692-93, and again in *Phillips, supra*, at 680:

> "'. . . Unreasonable charges exacted at this [the beginning] stage of the interstate movement become perpetuated in large part in fixed items of costs which must be covered by rates charged subse-

> quent purchasers of the gas including the ultimate consumer. It was to avoid such situations that the Natural Gas Act was passed.'"

Inability to recoup federally approved charges in one state must richochet against the congressional scheme and necessarily result in prejudice to federally protected consumers in other states.

In addition to the incompatibility of these orders with the legislative scheme of the Natural Gas Act, they burden interstate commerce and hence cannot stand under the Commerce Clause. The source of the federal-state conflict which inheres in the present case is the fact that appellant sells gas both in interstate and intrastate commerce, although only eight per cent of its annual sales are regulated under the latter. As a result, at least in this instance, we find a good example of the tail wagging the dog.

The state agency, while recognizing that the Federal Power Commission had already allocated appellant's Columbia Gulf charges equally between the demand and commodity components, nevertheless treated this expense as one chargeable only to commodity. It did this quite plainly to benefit West Virginia customers at the expense either (i) of appellant and its stockholders, or (ii) of appellant's interstate customers. By shifting from the demand component so large an element of appellant's costs attributable to retail sales in West Virginia (App. B, p. 8b), the state agency has attempted to inflict an excessive part of that cost element upon the retail consumers in other states who are served by appellant's interstate wholesale customers. Such a local discrimination at the expense of interstate commerce is inconsistent with the policy underlying the Commerce Clause and cannot be tolerated. See *Dean Milk Co.* v. *Madison*, 340 U. S. 349; *Southern Pacific Co.* v. *Arizona*, 325 U. S. 761; *Baldwin* v. *Seelig*, 294 U. S. 511; *Minnesota* v. *Barber*, 136 U. S. 313.

Finally, the state action here is one of due process dimension. The out-of-pocket loss to appellant is substantial and, over time, will result in impairment of the company's financial integrity if not absorbed in some other way by its interstate business or affiliated natural gas companies. The presumed absorption of this loss is implicit in the West Virginia Commission's determination. That presumption should be constitutionally forbidden when its postulates demand a readjustment of a federally sanctioned system of transportation and distribution on the one hand or a burden on interstate commerce on the other. Removing the presumption, there is nothing left for appellant but an inexorable series of annual losses. Certainly a determination of such an arbitrary character, resulting as it does in unavoidable losses, is destructive of appellant's financial integrity as contemplated by *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591.

2. The portion of the orders of the West Virginia Commission reducing the federal income tax expense in appellant's "cost of service" by resort to the Guideline depreciation procedures is so clearly inconsistent with the objectives of, and rights created by, Section 167 of the Internal Revenue Code and the Guideline Procedures promulgated thereunder as to require little discussion. Although this case is bottomed on the action of a state rather than a federal agency, the incorporation of federal laws was by specific and necessary reference. See *Standard Oil Co.* v. *Johnson*, 316 U. S. 481. In fact, as will be seen *infra*, federal law was actually applied by coercing an election under the Guideline Procedures.

Section 167 of the Internal Revenue Code is the basic depreciation provision allowing a taxpayer as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)

of property used in the trade or business or of property held for the production of income. Subdivision (b) permits the use of various methods of computing the "reasonable allowance", *viz.*, the straight-line method, the declining balance method, the sum of the digits method, and

> ". . . any other consistent method productive of an annual allowance, which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2)."

Subdivision (d) permits, under regulations prescribed by the Secretary or his delegate, the taxpayer and the Secretary or his delegate to enter into an agreement in writing specifically dealing with the useful life and rate of depreciation of any property.

Section 1.167(a)-1(b) of the Income Tax Regulations sets forth the various factors used in determining useful life, and Section 1.167(d)-1 contains provisions with respect to agreements by the taxpayer as to useful life.

Prior to the adoption of the new Depreciation Guidelines and Rules, Rev. Proc. 62-21, Treas. Pub. No. 456 (1962), the useful service lives had been contained in Bulletin "F" (last revised in January 1942) which was generally regarded as outdated in many respects. Bulletin "F" listed for each industry the average useful lives, in years, of various assets. The new Guidelines contained in Revenue Procedure 62-21 superseded Bulletin "F". They set forth new shorter lives applicable to broad classes of assets rather than the explicitly detailed items of depreciable property embodied in Bulletin "F". In a large number of places Revenue Procedure 62-21 made clear that these "guidelines"

were not mandatory, that their use was optional for the taxpayer, and that they were, as their title indicated, guides to the determination of useful lives to which the various depreciation procedures permitted under Section 167 might be applied.

The Guideline useful lives, if employed, being of considerably shorter duration than those presently used by appellant, would increase the depreciation deduction in the computation of federal income taxes and thus lower the tax allowance in appellant's cost of service.

There are several possible methods of treating the tax deferral resulting from rapid depreciation based on the use of the Guideline Procedures, each of which would preserve to the company at least the option of whether or not to change its depreciation, but until now no one has seen fit to destroy that option as the West Virginia Commission has done. These methods have generally developed in the treatment of liberalized depreciation under subdivisions (a) and (b) of Section 167. One method treats a regulated taxpayer on a "normalized" basis. In the context of the present case, this would mean that its tax expense for rate making purposes would be computed on a schedule of normal depreciation while permitting it to accumulate for modernization of plant the difference between that tax and the tax actually paid under the Guidelines. Such normalized treatment, coupled with the allowance of the normal rate on the reserve for deferred taxes, would achieve for the taxpayer all of the benefits of rapid depreciation and accomplish the congressional purpose of stimulating investment in plant.

A second method, adopted by the Federal Power Commission and sanctioned by a closely divided court of appeals in *Panhandle Eastern Pipeline Co. v. Federal Power Commission*, 316 F. 2d 659 (D. C. Cir. 1963), *petition for cert. filed*, 32 U. S. L. Week 3047 (U. S. July 16, 1963) (No.

277), permits normalization but divides unequally the benefits between the taxpayer and its customers. The third method, adopted by some state agencies,* requires the "flow through" of these benefits, that is, the taxpayer's "cost of service" is determined on the basis of an allowance for federal income taxes of the actual reduced tax expense incurred under rapid depreciation.

Until now, these three methods had been the only ones conceived and they were only applied to companies which had elected to use the alternative and more rapid depreciation procedure. It was assumed that the taxpayer would remain free to elect not to exercise the federally created option of rapid depreciation either because it was confronted with one of the latter two methods discussed above or because it believed its existing depreciation practices were adequate to maintain and replace its plant facilities.

Here, on the other hand, we find for the first time a decision of a regulatory agency not only that it will use the third or "flow through" method, but even more that it will treat the natural gas company's tax expense *as if* it had been computed on a schedule of rapid depreciation under the Guidelines even where the company had not so elected. Thus, the decision of the West Virginia Commission is tantamount to coercing appellant into exercising its federally created option, lest it abide the imposition of a fictitiously reduced income tax expense allowance in its cost of service calculation and hence an out-of-pocket loss as a result of the difference between the actual tax paid and the reduced tax expense allowed on the basis of a Guidelines depreciation deduction that was not claimed. Such forced election of that which Congress clearly intended to be optional is repugnant to Section 167 of the Internal Revenue Code and the Guideline Procedures promulgated thereunder.

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*See, *e.g.*, Cincinnati Gas & Electric Co. v. Public Utilities Commission, 173 Ohio St. 473, 184 N. E. 2d 84 (1962).

Apart from the question of who is to be benefited by the Guidelines, at the very least Congress intended the decision to make use of the more rapid depreciation under Section 167 to be at the option of the individual taxpayer. The entire statutory scheme and all the discussions which preceded its adoption abound with the notion of choice. Such words as "incentive" and "stimulus" are meaningless if the determination of the West Virginia Commission is permitted to stand. See H. Rep. No. 1337, 83rd Cong., 2d Sess., pp. 24-35 (1954). The Guidelines themselves, under the heading "Use of New Guideline Classes Not Mandatory," state that a "taxpayer may, if he desires, simply choose to have his depreciation claims examined under the procedures used in the past" (App. C, p. 11c).

And there are many reasons, emphasized in the Guidelines, why a taxpayer may wish or even feel compelled not to disturb its ordinary depreciation. Fairness to the next generation of consumers (Guidelines being merely a temporary tax deferral, to be made up by ratepayers in subsequent years), the fact that its plant is already modernized, and the maintenance of its retirement and replacement practices consistent with the life of its property, are typical examples.*

In short, appellant contends that, whether it should have all, only some, or even none of the benefits to be derived from more rapid depreciation under the Guidelines, it is

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*The evidence shows that the actual depreciation rates used by appellant are consistent with its retirement practices and received the full sanction of the West Virginia Commission in the instant case. The Commission's actions are inherently inconsistent, since it recognized the propriety of the actual depreciation rates used by appellant in computing the depreciation expense in appellant's cost of service and then, in the very next breath, rejected such rates and indulged in the fiction that Guidelines were used in computing appellant's federal income tax expense (App. B, p. 16b).

entitled, as a matter of federal right, to decline the congressional offer. It is submitted that this novel determination by the West Virginia Public Service Commission presents a question which is substantial and of considerable public importance.

Conclusion

For the foregoing reasons, probable jurisdiction of this appeal should be noted and a hearing on the merits should be granted.

Respectfully submitted,

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October 8, 1963.

APPENDICES

APPENDIX A

STATE OF WEST VIRGINIA

At a Regular Term of the Supreme Court of Appeals continued and held at Charleston, Kanawha County, on the 20th day of May, 1963, the following order was made and entered, to-wit:

United Fuel Gas Company, a Corporation

vs.

Public Service Commission of West Virginia

Upon petition for an appeal from, suspension and review of final orders made and entered by the Public Service Commission of West Virginia on October 17, 1962 and on December 13, 1962.

The Court, having maturely considered the petition filed herein on the 21st day of December, 1962, and note of argument in support thereof; the record consisting of all papers, documents and evidence which were before the Public Service Commission at the hearing which resulted in the entry of the final orders complained of; the statement of reasons for the entry of its orders made in Case No. 5536 on October 17, 1962 and December 13, 1962, filed herein by the respondent, Public Service Commission of West Virginia, on the 5th day of February, 1963; and the oral arguments of counsel on the 12th day of February, 1963, the date fixed by the Court for hearing upon the aforesaid petition; the Court is of opinion that the petitioner has not shown itself entitled to the relief prayed for in its said petition. It is therefore considered and ordered by the Court that the prayer of the petition for an appeal from, suspension and review, in this proceeding, be, and the same is hereby denied.

Appendix A

It is further ordered that leave be, and the same is hereby granted to the Public Service Commission of West Virginia to withdraw from the office of the Clerk of this Court the record consisting of all papers, documents and evidence originally filed with the Public Service Commission of West Virginia.

STATE OF WEST VIRGINIA

At a Regular Term of the Supreme Court of Appeals continued and held at Charleston, Kanawha County, on the 29th day of May, 1963, the following order was made and entered, to-wit:

United Fuel Gas Company, a Corporation

vs.

Public Service Commission of West Virginia

The order entered in this proceeding on May 20, 1963 came on for further consideration, upon the Court's being advised of a prospective appeal of this Court's judgment to the Supreme Court of the United States; and it appearing that the order of May 20, 1963 is incomplete, it is hereby ordered that the same be and it is hereby amended to read as follows:

Upon petition for an appeal from, suspension and review of final orders made and entered by the Public Service Commission of West Virginia on October 17, 1962 and on December 13, 1962.

The Court, having maturely considered the petition filed herein on the 21st day of December, 1962, and note of argument in support thereof; the record consisting of all papers, documents and evidence which were before the

Public Service Commission at the hearing which resulted in the entry of the final orders complained of; the statement of reasons for the entry of its orders made in Case No. 5536 on October 17, 1962 and December 13, 1962, filed herein by the respondent, Public Service Commission of West Virginia, on the 5th day of February, 1963; all of the questions grounded on the Constitution of the United States; and the oral arguments of counsel on the 12th day of February, 1963, the date fixed by the Court for hearing upon the aforesaid petition; the Court is of opinion that the petitioner has not shown itself entitled to the relief prayed for in its said petition, and that the Constitution has not been violated. It is therefore considered and ordered by the Court that the prayer of the petition for an appeal, suspension and review, in this proceeding, be, and the same is hereby denied.

It is further ordered that the record certified to the Clerk of this Court by the Public Service Commission of West Virginia, shall be held by the Clerk of this Court pending application by petitioner to the Supreme Court of the United States.

APPENDIX B

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

CHARLESTON

CASE NO. 5536

UNITED FUEL GAS COMPANY,
a corporation.
In the matter of increased
rates and charges.

Appearances:

CHARLES C. WISE, JR. and C. E. GOODWIN, Charleston, West Virginia, UNITED FUEL GAS COMPANY, Respondent.

EBER W. LIGHT, JR. and ELMER H. DODSON, Charleston, West Virginia, for THE CITIES OF CHARLESTON, HUNTINGTON, SOUTH CHARLESTON, LOGAN, NITRO, ST. ALBANS, DUNBAR, KENOVA, CHESAPEAKE and the COUNTY COURT OF CABELL COUNTY, WEST VIRGINIA.

R. L. STEWART and R. L. HART, JR., Counsel, A. BYRON CARVER, Chief Accountant, GEORGE R. HEATH, Assistant Chief Accountant, for the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA.

REPORT OF THE COMMISSION, October 17, 1962.

By the Commission:

Statement of the Case

On May 1, 1962, the respondent, United Fuel Gas Company, a corporation, filed with this Commission Second Revised pages numbers 4 and 5 to its Tariff designated

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P. S. C. W. Va. No. 8, cancelling First Revised pages 4 and 5 and Original pages 8 and 9, stating a schedule of increased rates and charges applicable to its general service customers served by it in the State of West Virginia, effective for all gas furnished on and after June 4, 1962. Said increased rates are designed to produce approximately $2,500,000 additional annual revenue from the Company's West Virginia business and are as follows:

General Service

Schedule No. 1

APPLICABILITY

See Index, Page 3, for applicability.

AVAILABILITY OF SERVICE

Available for general residential, commercial and industrial service.

Rate		
First	1,000 cubic feet used through each meter each month	$2.65 per thousand cu. ft.
Next	49,000 cubic feet used through each meter each month	.81 per thousand cu. ft.
Next	50,000 cubic feet used through each meter each month	.80 per thousand cu. ft.
Next	100,000 cubic feet used through each meter each month	.79 per thousand cu. ft.
Next	800,000 cubic feet used through each meter each month	.78 per thousand cu. ft.
All over	1,000,000 cubic feet used through each meter each month	.675 per thousand cu. ft.

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MINIMUM MONTHLY CHARGE

The minimum charge per month shall be $2.65.

PENALTIES OR DISCOUNTS

None.

Intrastate Utility Service

Schedule No. 2

APPLICABILITY

Applicable to intrastate utility customers served from the Company's facilities in West Virginia.

AVAILABILITY OF SERVICE

Available for service to intrastate utilities purchasing gas for resale within the State of West Virginia.

RATE

For all gas used through each meter each month $0.53 per thousand cu. ft.

MINIMUM MONTHLY CHARGE

The minimum charge per month shall be $25.00.

PENALTIES OR DISCOUNTS

None.

By order dated May 1, 1962, said rates were suspended and their use deferred until October 2, 1962. This Commission further ordered that United Fuel be made respondent to this proceeding and that the matters involved in the proceeding be set for prehearing conference on June 27,

1962, and that hearings in the matter be commenced on August 27, 1962. Prehearing conference was held as scheduled and was attended by all parties of record. Hearings were commenced on August 27, 1962, as scheduled and concluded August 30, 1962. Said order of May 1, 1962, further required United Fuel to give notice of said filing and of the time and place of the said prehearing conference and the commencement of hearings. Notice was given as required.

At said hearing evidence was presented by the respondent, by certain members of the Commission's staff and by witnesses appearing on behalf of the above named cities. Evidence was also given by James M. Honaker, a consultant employed by the Commission for the purposes of this case.

The case was submitted for decision on the entire record, on briefs filed by the respondent, the Commission's staff and the protestants.

PRINCIPLES INVOLVED AND STATUTORY REQUIREMENTS

In passing upon the justness of increased rates proposed by a natural gas utility this Commission is charged with the duty of administering the applicable provisions of the Public Utility Law of West Virginia. That law places the utility under the regulatory jurisdiction of this Commission and imposes upon it certain public service obligations. Those are that it shall provide adequate natural gas service to all persons within its territory who apply for service at rates which are just and reasonable, considering the cost thereof. The utility must serve without discrimination among customers and must expand its plant facilities so as to accommodate new customers who apply for service. The

law clearly entitles the utility to charge rates which will yield annual revenues sufficient to enable it to pay all of its operating expenses, pay its taxes, provide for depreciation of its properties and produce a fair return on a fair valuation of the property used to provide the service. It is the duty of the Commission to prescribe rates which will fulfill these requirements. It is also the duty of the Commission to require the utility to operate efficiently and economically.

The method of fixing rates generally used by this Commission is referred to as the Rate Base Method. The fundamental principles and objectives of this method are clearly set forth in previous Reports of this Commission, particularly in the case of Cumberland and Allegheny Gas Company, Case No. 4313, decided January 12, 1957. Without going into as much detail of the principles and problems of rate making as were narrated in the Commission's Report and the dissenting opinion in that case, it can be said that the Commission's primary objectives in this case are:

1. To verify the annual revenues collected by the Company and compare them with the annual expenses of providing the service so as to determine the amount available for return on investment. An audit of the Company's books by the Commission's Accounting Staff was made for this purpose.

2. To establish a Rate Base to which a rate of return can be applied.

3. This utility has extensive interstate operations in addition to its operations in West Virginia, and is subject to regulation by this Commission and the Federal Power Commission, which regulates its interstate sales. Its system

is integrated so as to serve all of its customers at all times without regard for State lines. The next problem then is to establish and apply a fair method of allocating its costs so that only that portion of its properties used and expenses incurred to provide service to West Virginia customers will be included in its West Virginia cost of service.

4. To make some provision for what has come to be known as attrition, i.e., the erosion of its earnings due to constant additions to its property made necessary by its obligatory expansion and growth, plus the higher prices it must pay for labor and material. Rates are made for the future. If the plant investment remained static and its revenues and expenses remained constant year after year, no rate adjustments would be necessary. However, United Fuel is continually adding plant on which it is entitled to earn a return, and during periods of inflation must pay higher prices for its materials and supplies and raise wages of its employees in keeping with current levels.

5. The Commission must prescribe a rate of return to be applied to the rate base. Rate of return depends upon the cost of money. The capital structure of The Columbia Gas System, Inc., parent company of respondent, consists partly of debt—money borrowed from investors through bonds sold by it—and partly of equity, i.e., money put up by the stockholders. The law is well settled that the utility is entitled to a return sufficient to preserve its financial integrity and attract capital needed for its growth; accordingly an inquiry must be made, and was made in this case, into the current cost of both debt and equity capital.

The foregoing principles and considerations were followed in this case.

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In order to determine whether a business enterprise is earning or losing money, and to ascertain the extent of such gain or loss, it is necessary to examine its fiscal affairs over a sufficient period of time to obtain an average thereof. The calendar year 1961 was used as the test period in this case. We found in the last rate case of this utility that 6.4% was a fair rate of return. The Company seeks a return of 6.5% in this case.

FACTS DISCLOSED BY THE EVIDENCE

United Fuel is a West Virginia corporation engaged in the business of producing, purchasing, transporting, storing and distributing natural gas at retail and wholesale. All of its sales are subject to governmental regulation. Its system is completely integrated and operated as one vast unit. It consists of 4,774 miles (3" equivalent) of transmission lines, 2,244 miles (3" equivalent) of distribution lines, 19 storage fields, 28 compressor stations, 1,927,602 acres of leaseholds, 3,881 gas wells, and all the concomitant facilities incident to its operation such as meters, regulators, tools, offices, warehouses, pipe yards and motor equipment. It employs 2,357 persons to operate the system.

The principal West Virginia cities served are Charleston, Huntington, Logan, Williamson, Pt. Pleasant, St. Albans, South Charleston, and Nitro. The Company has 120,116 customers of which 120,102 are in West Virginia. Although numerically the great majority of its customers are domestic and commercial customers, more than nine-tenths of the gas sold is to wholesale customers outside the state. Of its 120,102 West Virginia customers 109,429 are residential customers, of whom 109,182 use gas for space heating.

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The demands of its customers for gas vary widely between summer and winter and its plant is designed to supply all demands made upon it on the coldest day in winter when gas for space heating is used at the maximum. Until about seventeen years ago it obtained all the gas it needed from the so-called Appalachian Region, but because of the steady increase in demands since the war, it has had to purchase more and more southwest gas, which comes from Louisiana and Texas through the big-inch pipelines. At present more than 80% of all gas sold by United Fuel comes from the southwest. This gas is purchased at rates fixed by the Federal Power Commission. The gas can be purchased at lower cost if it is taken at a high load factor, i.e., in constant quantities throughout the year, so to obtain this advantage and at the same time meet its high wintertime demands and avoid a summer surplus, United Fuel stores large quantities in summer, when its demands are small, for use in winter. It buys a portion of its gas from independent producers and obtains a portion from its own wells. By far the greatest item in its total cost of service is the cost of purchased gas and the expense of having it transported from the southwest.

The growth of the Company since the war has been remarkable. The law requires it to expand so as to meet new demands, and it is this expansion, at the high costs which have prevailed in recent years, that makes higher rates for its service necessary. In 1954 the Company sold 21,922,419 Mcf of gas in West Virginia, while in 1961 it sold 39,137,248 Mcf, an increase of 78%. Between 1948 and 1961 the Company spent $155,851,459 expanding its overall plant to meet new demands. It has spent $39,718,084 for expansion since 1958. Its West Virginia net distribution plant investment per retail customer in 1954 was $85.

By 1961 this per customer investment had risen to $156 and is estimated to be $166 in 1962. It spent $57,177,800 in 1954 for purchased gas and in 1961 such cost had risen to $167,871,928. In 1954 the average cost of purchased gas was 25.68¢ per Mcf while in 1961 the cost had risen to 36.68¢. Among its 57 suppliers of southwest gas it had 98 rate increases between 1958 and September 14, 1960, and numerous increases since.

RATE BASE

In previous rate cases before this Commission by natural gas utilities, including United Fuel, the companies have contended for a calculation of rate base which would have resulted in a higher figure than that obtained by using the net depreciated original cost of its property. This Commission, however, has rather consistently adhered to the use of net depreciated original cost and United Fuel in this case has calculated its revenue deficiency by using net depreciated original cost. Accordingly, no controversy arose in this case over the method of calculating rate base. We believe, however, that since net depreciated original cost results in a lower figure than would result should some other method of rate base be used, that to confine the Company to earnings on its original cost rate base is to disregard the change in property values which in recent years has resulted from inflation, a change of common knowledge, and that a pragmatical adjustment should be made to it once it is established for the purpose of preventing an erosion of the Company's earnings because of attrition as hereinafter discussed. We will, therefore, continue to adhere to the use of original cost rate base to which we will make certain adjustments in our treatment of attrition.

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ALLOCATIONS

West Virginia customers should pay rates based only on the Company's West Virginia cost of service. Since the Company's properties are used and its costs incurred to serve all of its customers, both within and without the state, and since its properties cannot be segregated it becomes necessary to devise and apply a method of allocating to the West Virginia business that portion of the costs incurred to serve West Virginia customers.

Over the years the method of allocating costs of service in the main has become fairly well settled, although some controversy still arises in each case over this problem. The Company's method, which has been and is recognized in principle by the Commission, is based on the fact that its plant is designed and operated for a dual purpose. One is to meet the peak demand in winter, the other to furnish all gas needed by the customers on an annual basis. Obviously the plant capacity needed to meet peak demands is excessive and only partly used in summer. If the Company could sell exactly the same quantity of gas each day of the year, the problem would not arise and the Company could design and operate a much smaller plant. The objective is to ascertain and assign to each of the jurisdictions in which the Company operates its proper portion of the costs incurred in supplying the annual volumes and the additional costs incurred in meeting peak demands. Costs incurred in supplying the annual volumes are called commodity costs, while the additional costs incurred to meet peak demands are called demand costs. The Company classifies its costs between demand and commodity. Some costs are assigned wholly to demand and some wholly to commodity; however, a large portion are divided between demand and commodity. Such

mixed costs are incurred in meeting both peak time and annual volume requirements. Once the costs are classified they are allocated between West Virginia customers and other customers on the basis of sales in West Virginia, first on a 3-day sustained peak for demand costs, and then on an annual volume basis for commodity costs. The Company reported that of the demand costs 12.786% were chargeable to West Virginia service and of commodity costs 8.372% were chargeable. This is another way of saying that on the 3-day peak West Virginia was using 12.786% of the Company's plant capacity since that percentage of deliveries was made in West Virginia during the peak demand, while over the course of a year 8.372% of total deliveries were in West Virginia.

The allocation factors as developed by the Staff differed slightly from the above and the Company agreed with the Staff's calculations. They were 12.712% for demand and 8.278% for commodity. In this case the Commission's Staff, the protestants, and the Company allocated demand costs on the basis of deliveries on the 3-day peak of the test year which occurred during January, 1961, thereby eliminating any controversy over the peak period which should be used.

COLUMBIA GULF

The Company and the staff disagreed over the classification between demand and commodity of the costs paid by United Fuel to Columbia Gulf Transmission Company for the transportation of gas by Columbia Gulf from Louisiana to the Kentucky-West Virginia line. The Company classified those costs about 50% to demand and 50% to commodity. The staff classified them 100% to commodity.

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The function of Columbia Gulf, as disclosed by the evidence in this case, is to deliver annual volumes of gas to United Fuel in substantially equal volumes each day of the year. There is no excess capacity in the Columbia Gulf system which is used to meet peak demands but lies unused and unneeded during off-peak periods.

The function of the transportation of gas by Columbia Gulf is precisely the same as the function of the gas purchase in Louisiana. Only the location of the gas is changed. The time of its availability remains the same. The gas purchase costs are classified 100% to commodity by the Company and the Staff.

To the extent that it may be said that more of the gas transported by Columbia Gulf is delivered to United Fuel's customers during the winter months than during the summer (except for minor amounts), it is gas delivered from underground storage which is involved. It is the storage rather than the transportation by Columbia Gulf during the summer which makes these volumes available during the winter. The costs of the Company's storage operations have been divided between demand and commodity by both the Company and the staff.

The *amount* paid Columbia Gulf is determined by Columbia Gulf's cost of service computed as provided by its FPC tariff. The *purpose* for which United Fuel pays the money, however, is to obtain gas, and becomes in the final analysis no more than a cost of purchased gas to United Fuel. Since United Fuel classifies its other purchased gas costs to commodity (except for demand costs billed by and paid to Tennessee Gas Transmission Company) and appears content to do so, there appears to be no good reason why the Columbia Gulf costs should not be so classified. We will follow the Staff's method and assign the costs to commodity.

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It should be noted that this is the third major rate case of United Fuel in which this same issue has been raised by the Company. It was decided the same way by the Commission in the other two cases and was one of the two issues on which the Company sought to have the decision in Case No. 4936 reviewed by the Supreme Court of Appeals. The review was denied.

ATTRITION

According to theoretical and classical concepts of utility rate making, additions to plant result in a corresponding increase in business, e.g., a $100.00 addition to a $1,000.00 plant serving 10 customers would bring one new customer to whom would be sold 10% more gas so that the Company would earn the same return on its investment after the addition as before. However, the classical concepts presuppose that the dollar has a constant and uniform purchasing power as time goes on, a fact we all know has not existed during the past fifteen years. Increase in plant investment has not resulted in the addition of a proportionate increase in new customers, nor in a proportionate increase in new business. This problem is difficult for the utility, because it *must* expand, and equally difficult for the regulatory commission. It is well established, and this Commission recognizes, that the obligatory growth and expansion of a gas utility often results in an erosion of the return it has been authorized to earn. The old customers must share the weight of the over-all increases in per customer investment because of the statutory provision forbidding discrimination. Rates are made for the future based on the financial experience of the utility in the past. We cannot prescribe rates which will enable the utility to re-

coup losses in the past, whether such losses resulted from attrition or a regulatory lag, but can fix rates sufficient only to provide the utility a fair return on its present investment. On the other hand, we cannot disregard evidence of planned and budgeted future expansion when such evidence appears to be no more than a reasonable projection of past experience.

It was also shown above that we are using a net depreciated original cost rate base, a rate base which also loses some of its classical virtues during a time of progressive inflation.

To adjust for the foregoing inequities and at the same time preserve the use of original cost rate base, we will make a special allowance in the amount of $178,529.00, using the same method employed and explained in detail in the cases of United Fuel Gas Company, Nos. 4936 and 4597.

OTHER ADJUSTMENTS TO COST OF SERVICE

Numerous other adjustments have been made to the Company's over-all cost of service. Some require brief comment.

Lost and Unaccounted-for Gas. In this case, unlike previous ones, the Company, the staff and the protestants made their respective computations of the cost of service using the Three-inch Equivalent Method. By this method all of the Company's lines are converted into Three-inch Equivalent. Then the actual total unaccounted for gas of the Company is related to the miles of pipe as so converted. This method has been recommended by the Engineering Department of this Commission. Accordingly, we find that the Three-inch Equivalent Method is appropriate in this case.

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Allocation of Administrative and General Expense. These expenses are incurred in the over-all operations of the Company's business and must be assigned to the various functions of the Company. There is no perfect way to allocate such costs, and the method used in the last case, No. 4936, appears to obtain a reasonably fair result and it also has the merit of simplicity of application. This method assigns the cost among the functions on the basis of the labor costs of each function. We find that such method is appropriate in this case, except the adjustment made by the Commission's staff as to certain communications equipment which should be assigned to the transmission function.

Federal Tax Issues. Since the amendment of the Federal Internal Revenue Code of 1954, authorizing corporations to elect whether to use straight line of accelerated depreciation, numerous public utilities which this Commission regulates have used accelerated depreciation in computing and paying income taxes, but have claimed as a tax expense for rate making purposes an amount they would have paid had straight line depreciation been used. We have consistently refused to permit such a tax expense and have allowed as income tax expense only the amount actually paid. We believe the utility's position on this question is no more than fiction and that an income tax expense should not be allowed unless the tax is actually being paid. As an income tax expense, we will therefore allow the actual amount paid.

In July of 1962 the Internal Revenue Service promulgated and issued new guidelines and rules for depreciation of corporate properties for income tax purposes. The new guidelines provide for higher depreciation rates which may be used by United Fuel to decrease the income tax which must be paid by its customers. At the hearing the

Company stated that it was studying the question of whether to use the new guideline rates and had not decided whether it would use them or not. The Company did not state any reason for not using them nor any way in which it might be adversely affected by using the new rates. On the contrary, it appears from the rules themselves that the Company may use the higher depreciation rates set forth in the guidelines without question or penalty for at least three years. Use of the guidelines rates might have to be discontinued after three years if they were shown not to be in accordance with the Company's retirement practices.

The Company has a duty to take advantage of all reasonable economies in the operation of its business and to pass on the savings therefrom to its customers. Since the record is devoid of any evidence showing that use of the new guideline rates would adversely affect United Fuel, the new depreciation rates will be used in computing the Company's income tax for inclusion in the cost of service.

Book Depreciation. The protestants in this case urged that the higher depreciation rates adopted by the respondent in 1957, and since used, should not be allowed but that the prior depreciation rates should be applied. This issue was raised in the last case, No. 4936, decided September 14, 1960, and for the reasons stated in the Commission's Report in that case, we again approve the depreciation rates approved in that case. It is not unusual for industrial corporations, as well as public utility corporations, to charge on their books depreciation expense based on rates which are different from the rates permitted and used in computing their income tax liability.

Consolidated Tax Savings. United Fuel does not file an income tax return and pay a tax thereon, being one of a

number of subsidiary companies of The Columbia Gas System, Inc. It contributes its proportionate part to the consolidated income tax paid by Columbia Gas. A saving results to United Fuel because its contribution to the consolidated income tax liability of Columbia Gas is less than its tax would be if it paid a separate income tax.

The income tax of Columbia Gas had not been calculated nor paid at the time of the hearing in this case since such corporations make and file their income tax in September, following the tax year. Accordingly, in this case, the consolidated tax saving was not known. United Fuel estimated that the saving to it would be 6%. The Commission's staff reported the saving to be 7.13%, which was the actual saving resulting from the consolidated income tax of Columbia Gas for 1960. The protestants in the case recommended an even greater income tax saving to United Fuel. We will follow the recommendation of the Commission's staff in this regard and calculate United Fuel's income tax on the basis of a 7.13% saving due to the consolidated return.

Progression and Merit Wage Increases. The Company's cost of service included an item for progression and merit wage increases which it stated were essential to meet competitive conditions in the labor market. The staff's cost of service is computed on the same basis. The protestants urge the disallowance of this item. From the evidence it appears that wage increases of this type have been experienced in the past and are likely to be experienced in the future. Accordingly, we are of the opinion that such increases are a proper item and should be allowed.

Columbia Gulf Liberalized Depreciation. As hereinabove explained, United Fuel pays large sums of money

each year to Columbia Gulf Transmission Company for the transportation of gas to West Virginia from Louisiana. As was stated above, the charge made to United Fuel by Columbia Gulf is on a cost-of-service basis, under a tariff which has been approved by the Federal Power Commission. Columbia Gulf, in computing its income tax liability, uses accelerated depreciation, but for rate purposes and charges to United Fuel, uses straight-line depreciation, using the normalization method in the treatment of this tax computation which has the approval of the Federal Power Commission. This Commission has held that if United Fuel elects, under the Revenue Act, to use accelerated depreciation, that it must allow the saving thus effected to flow through so that the rate payers receive the benefit thereof. The Federal Power Commission has approved the normalization method and permits the utility to retain the saving thus effected and to normalize it as a reserve for so-called future tax liability. Clearly, Columbia Gulf has the right under the Internal Revenue Law to make this election and the Federal Power Commission has approved the normalization method.

The protestants in this case urged that United Fuel's cost of service be computed on the basis of Columbia Gulf having used accelerated depreciation and allowing the saving to flow through to United Fuel. The amount that United Fuel pays Columbia Gulf is arrived at by tax procedures followed by Columbia Gulf and approved by the Revenue Department and the Federal Power Commission. United Fuel must pay this money. To deny United Fuel this expense in part because of tax procedures followed by Columbia Gulf appears to us to be entirely improper. The transportation charges made by Columbia Gulf are solely under

the jurisdiction of the Federal Power Commission, and this Commission is powerless to control any part thereof.

Rate of Return. In Case No. 4936, involving United Fuel, we found a rate of return of 6.4% to be proper. Our reasons therefor were given in considerable detail in the Commission's Report in that case.

In the present case, the Commission employed the services of James M. Honaker, a public utilities consultant and economist, to make a study of the cost of money to The Columbia Gas System, and to testify thereon at the hearing in this case. Witness Honaker prepared an exhibit on the subject, which is quite complete and largely self-explanatory. His testimony explained and elaborated upon his exhibit and he concluded by giving the opinion that a proper rate of return for United Fuel in this case is 6%. He arrived at this figure by considering that the capital structure of Columbia Gas is approximately 55% debt and 45% equity and that the cost of debt is 4.25% and the cost of equity 7.5%. We conclude that 6% rate of return is proper.

Having determined the West Virginia portion of United Fuel's rate base to be $37,736,773 (the staff's computation, plus the attrition allowance) and the rate of return to be 6%, and having satisfied ourselves as to the adjusted operating expenses of the Company, we find the deficiency in annual revenue to be $361,104 and that rates should be adjusted upward so as to produce this amount. The rates we will authorize are so designed.

It may be noted that of the revenue deficiency aforesaid the Company needs only $181,301 to provide the return we find proper, the balance of $179,803 being necessary for federal income taxes, higher cost of purchased gas, higher labor costs, and other increases in operating costs.

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Commissioner Townsend disagrees in part with the foregoing and will file a dissenting opinion.

Commissioner Brown disagrees in other respects and will also file a dissenting opinion.

MEMORANDUM OF COMMISSIONER BROWN STATING REASONS FOR DISSENTING IN REGARD TO THE COMMISSION'S ALLOWING ATTRITION AND USE OF THREE-INCH EQUIVALENT IN COMPUTATION OF LOST AND UNACCOUNTED-FOR GAS

I respectfully file my dissent from the Commission's decision in this case on two points; namely, attrition and the use of the three-inch equivalent method in computing lost and unaccounted-for gas.

ATTRITION

Attrition has been allowed by the West Virginia Public Service Commission in United Fuel rate cases since 1959, on the basis of adjusting the rate base to recognize increased costs in addition made to plants. Attrition is a matter which in effect, if allowed, increases the Rate of Return and is a projection by this Commission, to some extent, into the United Fuel Gas Company's experience into the future.

The decision in this case approves a 6% Rate of Return, which would enable United Fuel Gas Company to pay its bond interest, a reasonable dividend on equity money invested in the Company, and leave sufficient margin to accrue to surplus to provide for periods of depressed activity due to economic conditions and other circumstances. An attrition allowance of $178,529.00, which is a separate and special allowance outside the test period to compensate United

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Fuel for distribution plant costs added at increased unit cost for each new customer added, although not necessarily for the purpose of serving only new customers, would, in this case, increase the Rate of Return from 6% to 6.2% plus.

The allowance of a 6% Rate of Return gives, in my opinion, sufficient allowance above the cost of money to provide for any attrition. I would accordingly deny the $178,529.00 attrition, as an addition to United Fuel Gas Company's rate base.

LOST AND UNACCOUNTED-FOR GAS

The matter of computing the lost and unaccounted-for gas is one which is certainly not developed by the record in this case; however, the importance of using a sound and reasonable method in computing the amount of lost and unaccounted-for gas to be included in the distribution system in the development of capacity and commodity factors cannot be disputed.

This Commission has heretofore computed the lost and unaccounted-for gas on the basis of available gas to lost and unaccounted-for gas for the entire system based on a ten-year average. This method was used in the most recent United Fuel rate case, using a 2.042% to compute the percent of lost and unaccounted-for gas. And, if this method was employed in the case at bar, it would be 1.5063%.

This Commission has allowed in this case 3.7675%, in contrast to 2.042% allowed in the last rate case of United Fuel. Admittedly, this item cannot be determined to a mathematical certainty; however, the three-inch equivalent method does not take into consideration the differences of

line pressures in the production, transmission and distribution systems.

I would disallow the use of the three-inch equivalent method and give equal weight to the three-inch equivalent method and the percentage of unaccounted-for gas to the total available gas in the test year. The latter method results in a 2.344% and would reduce West Virginia's cost of service by $182,575.00, as compared with the three-inch equivalent method approved by this Commission.

In view of the reasons stated above in my dissent, it is my considered opinion, based upon the record before the Public Service Commission in this case, that United Fuel Gas Company's present rates are sufficient to produce a fair and equitable return. Therefore, in my opinion, United Fuel would not be entitled to any increase in rates as applied for in the present case.

VIRGINIA MAE BROWN
MEMBER

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PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA

CHARLESTON

CASE No. 5536

UNITED FUEL GAS COMPANY,
a corporation.

In the matter of increased
rates and charges.

DISSENTING OPINION OF COMMISSIONER TOWNSEND TO THE DECISION AND REPORT OF THE COMMISSION OF OCTOBER 17, 1962.

BY COMMISSIONER TOWNSEND:

I disagree with the decision of the Commission on three points, viz:

1. The treatment of the assignment of respondent's Columbia Gulf expense between the demand cost component and the commodity cost component.

2. The computation of respondent's income tax expense under the assumption that respondent used the Treasury Department's Guidelines and Rules in the determination of its depreciation deduction.

3. The rate of return.

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COLUMBIA GULF EXPENSE

During the test period United Fuel paid Columbia Gulf $37,977,296 for transporting its (United Fuel's) gas from Louisiana to West Virginia. In the assignment of costs between the demand cost component and the commodity cost component, the majority assigned all of the Columbia Gulf expense to the commodity component. In the last United Fuel rate case before this Commission, decided September 14, 1960, I concurred with the other Commissioners, with some reservations and reluctance, in assigning all of this expense to commodity. I have since been persuaded that such assignment was erroneous, and that the expense should be assigned approximately 50% to demand and 50% to commodity. Since West Virginia's portion of the demand cost is 12.71%, and of the commodity cost 8.27%, the difference is substantial.

A brief restatement of the method of, and reasons for, the assignment and allocation of United Fuel's cost of providing its service may be in order.

United Fuel operates a vast integrated natural gas utility system which is constructed and operated to serve all of its customers with an adequate supply of gas, both within and outside West Virginia, at all times, winter and summer. The Federal Power Commission regulates and prescribes rates for its interstate sales; this Commission regulates its West Virginia sales. The purpose of cost classification and allocation is to ascertain the portion of the Company's entire costs that are incurred to serve the interstate customers and the portion incurred to serve the West Virginia customers. West Virginia rates should yield revenue sufficient to discharge the costs of serving West Virginia customers,—no more and no less.

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United Fuel is clearly entitled to, and must, recover all of its system-wide costs. Should interstate rates produce the revenue sufficient in amount to defray the costs of its interstate sales and West Virginia rates should produce less than enough to defray the costs of its West Virginia sales, then United Fuel has sustained an irretrievable loss. The fact that the F. P. C. has classified the Columbia Gulf expense partly to demand and partly to commodity and this Commission has classified such costs entirely to commodity, produces exactly this result.

The next question then is whether the F. P. C. is correct or this Commission is correct. I would consider it an abandonment of duty to presume that this Commission is wrong in its decision of this question simply because the F. P. C. has reached a different decision, and will, therefore, now present other reasons for my views.

The method of classifying costs and allocating them to the different jurisdictional sales has become fairly well established over the years and has been approved and adopted in the main by this Commission. It is not perfect, but none better has been presented. The method stems from the fact that a large interstate gas utility system such as United Fuel's is designed for a dual purpose. One is to meet the peak demand, i.e., to supply all of its customers with gas on the coldest day in winter when gas for space heating is being used at the maximum, the other is to provide sufficient gas and facilities to meet the total annual requirements. A large portion of the plant facilities are of excessive capacity and unused in the summertime yet must be maintained and kept ready for use in winter. United Fuel has constructed and maintains such a system. The system is completely integrated and its gas is pooled so as to be available for delivery

any place in the system at any time. The gas comes into the system from innumerable sources. Gas is completely fungible and once in the pool the identity of its source and origin is lost.

The gas which is transported from Louisiana to West Virginia by Columbia Gulf is purchased by United Fuel in Louisiana. Columbia Gulf's only function is to transport the gas. Therefore, the cost to United Fuel for this service is a transmission cost, i.e., a cost incurred for having its gas moved from one place to another. United Fuel has a transmission system of its own, mostly in West Virginia. The costs of operating this system are, and have been, assigned partly to demand and in part to commodity.

Only 8.278% of United Fuel's total sales during the test year were in West Virginia. However, at the peak period 12.712% of all gas sold was in West Virginia. It is because the consumers in the various regulatory jurisdictions (two in this case) make different use of the system in summer than in winter that cost accountants seek to assign and allocate the total service costs so as to be commensurate with the annual volumes consumed and the peak time consumption in each jurisdiction. To attain this objective they divide all costs into two categories: demand costs, which are costs incurred solely to meet peak demands, and commodity costs, which are costs incurred in supplying the total annual volumes. Costs incurred solely to meet the peak demand are assigned to the demand factor while costs which vary directly with volumes of gas sold are assigned to the commodity factor. It will at once be seen that some costs are incurred for both purposes and these are assigned partly to the demand and partly to commodity, usually on a 50-50 basis. By far the larger portion of total costs are considered

mixed costs and assigned part to demand and part to commodity.

The question here is whether the money United Fuel pays to Columbia Gulf for transporting its (United Fuel's) gas from Louisiana to West Virginia is such a mixed cost. United Fuel buys the gas in Louisiana and owns it enroute.

It is undisputed that under the contract between United Fuel and Columbia, United Fuel pays for the full capacity of Columbia's line and must make the payments regardless of the quantity of gas transported. It would have to pay, even if no gas were transported. However, the opposing argument went that because United uses the line at full load factor and full capacity that no part of this transportation service goes to meet peak demands, and that, therefore, no element of demand cost is involved and that all of the cost should be classified to commodity. The evidence is, however, that normally United Fuel uses the line at about 90% of capacity, leaving 10% available if peak demands should increase. But there is a greater fallacy to the argument. United Fuel, by using the line at a high load factor and near capacity thereby obtains a lower unit (Mcf) cost in having the gas transported. United Fuel so operates its business that it can make high use of the line and thus effects an economy it would not have should it use the line at low load factor or in varying quantities at different times. Since United Fuel must pay for use of the line regardless of quantities transported, the fact that it is used at high load factor is coincidental and to deny United Fuel its costs by assigning them entirely to commodity is to penalize the Company because it is getting the most for its money and thereby effecting an economy which enures to the customers' benefit.

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United Fuel also receives gas from the southwest through the lines of Tennessee Gas Transmission Company. Part of this gas is owned by United enroute and part is purchased from Tennessee. All of the money paid to Tennessee is assigned partly to the demand factor and part to commodity.

In addition, United Fuel owns and operates as an integral part of its over-all system a transmission system of its own consisting of 4,774 miles (3" equivalent) of transmission lines. The costs of this transmission function, as it is called, is assigned part to demand and part to commodity.

The protestants in the case presented their contentions through the witness Wiskup, who undoubtedly is an expert of the highest order in the field of gas utility regulation. With apparent conviction he presented many reasons why numerous items of United Fuel's cost of service should be either disallowed or reduced. Significantly, however, he classified the Columbia Gulf costs, as did United, by dividing them between the demand and commodity factors.

GUIDELINES AND RULES

The majority's views on this subject are set forth beginning with the last paragraph on page eleven of the report. In the preceding paragraph under the side heading "Federal Tax Issues" the subject of accelerated depreciation is discussed.

The facts are that United Fuel did not compute its income tax expense by use of the Guidelines and has not yet elected to do so. The Guidelines were not in effect during the test period.

Here again, as in the use of accelerated depreciation, United has a complete option under the Revenue Act and

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Regulations whether to use the Guideline depreciation rates. To limit United's income tax expense to the amount it would have paid had the Guidelines been used is not in keeping with the facts and is totally inconsistent with the majority's treatment of accelerated depreciation. It denies to United a portion of its income tax expense by indulging in the fiction that the Guidelines were used. Thus the majority has done exactly the thing in this regard which it forbade United to do respecting accelerated depreciation.

RATE OF RETURN

I believe respondent is entitled to a rate of return of not less than 6¼%. In the last United Fuel case we approved 6.4%. Under the law the Company is entitled to a return sufficient to preserve its financial integrity and attract capital. The capital structure of Columbia Gas is approximately 55% debt and 45% equity. Witness Honaker recommended a 6% return at which I believe he arrived by considering the "bare bones" cost of money. Many authorities on the subject contend, with persuasive argument, that the bare cost of money is not sufficient for a utility which is growing and must grow and must continually add capital investment to meet the demands made upon it, since such bare cost allows nothing for the expense incident to refinancing debt and leaves out of account floatation costs and market resistance to new stock issues. The report describes the remarkable growth of United Fuel in recent years. Also, I believe Honaker underestimated the cost of both the Company's debt capital and equity capital. He states the cost of debt money to be 4.1%. This is a weighted average of the imbedded or historical cost of debt with the current cost. As the Com-

pany refinances and enlarges its debt capital, which it must do at occasional intervals, it will of necessity (unless the trend of very recent years changes drastically) be required to pay a higher percentage rate of interest for debt capital. Not very many years ago this money could be obtained at around 3.5%. Now it costs 4.5%. (Columbia Gas issue of June 7, 1962).

The net earnings of a utility is the product of multiplying a rate base by the rate of return. This return, or such net earnings, must cover interest on debt, a provision for reasonable retention of earnings in the business and the payment of reasonable dividends. As was pointed out in the report, we have used a net original cost rate base which is the lowest rate base that can be used. The report also stated that some provision would be made for this with respect to rate of return. In my opinion this has not been done. A 6% rate of return is out of line with, and lower than, the return fixed by this Commission in recent years in all comparable cases. There has not been any material change in the money market to justify such a reduction.

A few years back debt capital could be obtained by such a business enterprise as Columbia Gas at interest rates at or slightly above 3%. A drastic change has taken place in recent years. Such a company is now required to pay interest rates at from 4½ to 5% in order to obtain debt capital. I believe the reason for this is apparent. Investors, because of the inflationary trend during the past 15 years, now realize that when they commit their investment funds for long periods at a fixed interest rate, when they finally receive back the principal the dollars invested have a substantially lower purchasing power. Hence they are no longer willing to commit their money for long periods of

time at a fixed contractual interest rate as low as they were formerly willing to accept. I see no reason to believe that this trend will change. I believe further that the cost of equity money has risen. During the past 18 months a drastic decline has taken place in the value of corporate stocks listed on the major stock exchanges. On the New York Exchange alone $140,000,000,000 in stock values has been erased. During this decline in stock values there has been no sufficient corresponding decline in earnings or dividends which would justify the reduction in values for that reason. This indicates that generally and broadly speaking the investor in corporate stocks is no longer willing to advance as much money as formerly for the return he may expect to get. Investors now are simply unwilling to advance as much money for the same amount of earnings and dividends as they were formerly willing to do.

As stated above, I believe that in the immediate future and for the reasons above set forth, that the cost of both debt and equity capital will be somewhat higher than in the recent past.

HILLIS TOWNSEND

October 30, 1962

Appendix B

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, at the Capitol in the City of Charleston on the 17th day of October, 1962.

CASE No. 5536

UNITED FUEL GAS COMPANY, a corporation
In the matter of increased rates and charges.

This proceeding came on to be heard the 17th day of October, 1962, upon second revised pages 4 and 5 to its tariff designated P. S. C. W. Va. No. 8, filed on May 1, 1962, by United Fuel Gas Company, a corporation, stating a schedule of increased rates and charges applicable to its general service customers served by it in the State of West Virginia, to become effective on and after June 4, 1962; upon all of the evidence adduced and orders entered herein and upon the entire record in this proceeding.

Upon consideration of all of which and for reasons set out in the report of this Commission, this day filed herewith and made a part hereof, the Commission is of opinion and finds that the rates the respondent had in effect during the calendar year 1961, the test period in this case, were not just and reasonable in that they did not produce sufficient annual revenue to enable the respondent to pay its reasonable and necessary operating expenses, including taxes and depreciation, and yield a fair return on its property used and useful in its intrastate West Virginia business.

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The Commission further finds that the rates and charges stated in the said second revised pages 4 and 5 are likewise unjust and unreasonable for the reason that they would produce revenue much in excess of that required for the purposes hereinbefore mentioned.

The rates hereinafter set forth are found to be just and reasonable in that they will produce sufficient annual revenues for the aforesaid purposes.

It is, accordingly, ordered that respondent's aforesaid second revised pages 4 and 5 to its tariff designated P. S. C. W. Va. No. 8 be, and the same hereby are, canceled and stricken from the tariff files of this Commission.

It is further ordered that respondent, United Fuel Gas Company, be, and it hereby is, permitted and authorized to place into effect, on all meter readings made on and after the date hereof, the following schedule of rates and charges:

General Service

Schedule No. 1

AVAILABILITY OF SERVICE

Available for general residential, commercial and industrial service.

Rate		
First	1,000 cubic feet used through each meter each month	$2.55 per thousand cu. ft.
Next	49,000 cubic feet used through each meter each month	.72 per thousand cu. ft.

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Rate		
Next	50,000 cubic feet used through each meter each month	.70 per thousand cu. ft.
Next	100,000 cubic feet used through each meter each month	.69 per thousand cu. ft.
Next	800,000 cubic feet used through each meter each month	.68 per thousand cu. ft.
All over	1,000,000 cubic feet used through each meter each month	.59 per thousand cu. ft.

MINIMUM MONTHLY CHARGE

The minimum charge per month shall be $2.55.

PENALTIES OR DISCOUNTS

None.

Intrastate Utility Service

Schedule No. 2

APPLICABILITY

Applicable to intrastate utility customers served from the Company's facilities in West Virginia.

AVAILABILITY OF SERVICE

Available for service to intrastate utilities purchasing gas for resale within the State of West Virginia.

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RATE

For all gas used through each meter each month $0.50 per thousand cu. ft.

MINIMUM MONTHLY CHARGE

The minimum charge per month shall be $25.00.

PENALTIES OR DISCOUNTS

None.

Respondent will file with this Commission a tariff stating the rates and charges herein authorized.

It is further ordered that the respondent be, and it hereby is, required to advise the Commission promptly of any refunds from its suppliers pursuant to any final order of the Federal Power Commission in any case pending on the date of this order, in order that the Commission may take appropriate action relative thereto.

A Copy.

Teste:

M. F. WRIGHT, JR.
Secretary

Appendix B

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

CHARLESTON

At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, at the Capitol in the City of Charleston on the 13th day of December, 1962.

CASE NO. 5536

UNITED FUEL GAS COMPANY, a corporation.

In the matter of increased
rates and charges.

Petitions for rehearing and reargument.

This proceeding came on for consideration on this the 13th day of December, 1962, upon the duly verified petition of the respondent, United Fuel Gas Company, a corporation, filed October 26, 1962, and its amended petition for rehearing and reargument filed November 14, 1962, in connection with the order entered herein on October 17, 1962, and upon the orders heretofore entered and proceedings heretofore had.

Upon consideration whereof and of the entire record in this case, the Commission is of opinion and finds that the matters alleged in said petitions were fully considered by the Commission before the entry of its said order of October 17, 1962, and that said petitions of the United Fuel Gas Company for rehearing and reargument should be denied; and IT IS SO ORDERED.

Commissioner Townsend would reopen the case and alter the decision in accordance with the views expressed in his dissenting opinion of October 30, 1962.

A Copy.

Teste:

M. F. WRIGHT, JR.
Secretary

APPENDIX C

Internal Revenue Code of 1954

Section 167

(a) General rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(b) Use of certain methods and rates.—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

(1) the straight line method,

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which

would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) Limitations on use of certain methods and rates.— Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—

(1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1953, or

(2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

(d) Agreement as to useful life on which depreciation rate is based.— Where, under regulations prescribed by the Secretary or his delegate, the taxpayer and the Secretary or his delegate have, after the date of enactment of this title, entered into an agreement in writing specifically dealing with the useful life and rate of depreciation of any property, the rate so agreed upon shall be binding on both the taxpayer and the Secretary in the absence of facts or circumstances not taken into consideration in the adoption of such agreement. The responsibility of establishing the existence of such facts and circumstances shall rest with the party initiating the modification. Any change in the agreed rate and use-

ful life specified in the agreement shall not be effective for taxable years before the taxable year in which notice in writing by certified mail or registered mail is served by the party to the agreement initiating such change.

(e) Change in method.—

(1) Change from declining balance method.—In the absence of an agreement under subsection (d) containing a provision to the contrary, a taxpayer may at any time elect in accordance with regulations prescribed by the Secretary or his delegate to change from the method of depreciation described in subsection (b) (2) to the method described in subsection (b) (1).

(2) Change with respect to section 1245 property.—A taxpayer may, on or before the last day prescribed by law (including extensions thereof) for filing his return for his first taxable year beginning after December 31, 1962, and in such manner as the Secretary or his delegate shall by regulations prescribe, elect to change his method of depreciation in respect of section 1245 property (as defined in section 1245(a) (3)) from any declining balance or sum of the years-digits method to the straight line method. An election may be made under this paragraph notwithstanding any provision to the contrary in an agreement under subsection (d).

(f) Salvage value.—

(1) General rule.—Under regulations prescribed by the Secretary or his delegate, a taxpayer may, for purposes of computing the allowance under subsection (a) with respect to personal property, reduce the amount taken into account as salvage value by an amount which

does not exceed 10 percent of the basis of such property (as determined under subsection (g) as of the time as of which such salvage value is required to be determined).

(2) Personal property defined.—For purposes of this subsection, the term "personal property" means depreciable personal property (other than livestock) with a useful life of 3 years or more acquired after the date of the enactment of the Revenue Act of 1962.

(g) Basis for depreciation.—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

(h) Life tenants and beneficiaries of trusts and estates.—In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. In the case of an estate, the allowable deduction shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each.

(i) Depreciation of improvements in the case of mines, etc.—

For additional rule applicable to depreciation of improvements in the case of mines, oil and gas wells, other natural deposits, and timber, see section 611.

Appendix C

As amended Sept. 2, 1958, Pub. L. 85—866, Title I, §89(b), 72 Stat. 1665; Oct. 16, 1962, Pub. L. 87—834, § 13(b), (c)(1), 76 Stat. 1034.

DEPRECIATION GUIDELINES AND RULES
REV. PROC. 62-21

INTRODUCTION

Revenue Procedure 62-21 provides basic reforms in the guideline lives for depreciation and in the administration of depreciation for tax purposes. It sets forth simpler standards and more objective rules which will facilitate adoption of rapid equipment replacement practices in keeping with current and prospective economic conditions.

It will not, however, supersede existing rules, outstanding arrangements, or established procedures for those who wish to continue to use them.

The Procedure becomes effective immediately and may be used in the preparation of any tax return due after the date of publication. The new guideline lives and new administrative procedures are applicable to all depreciable property, including existing assets as well as new acquisitions.

New guideline lives for machinery and equipment are set forth which, on the whole, average 30 to 40 percent shorter than those previously suggested for use by taxpayers. The new guidelines will automatically permit more rapid depreciation deductions than those presently taken on 70 to 80 percent of the machinery and equipment used by American business. They will not disturb the depreciation taken on the remaining 20 to 30 percent of business assets

on which depreciation is now as fast as, or faster than, that provided in the new guidelines.

A central objective of the new Procedure is to facilitate the adoption of depreciable lives even shorter than those set forth in the guidelines, or shorter than those currently in use, provided only that certain standards are met and that subsequent replacement practices are reasonably consistent with the tax lives claimed.

BASIC PRINCIPLES

Guideline Lives Based on Broad Asset Classes

The new, shorter guideline lives apply to about 75 broad classes of assets, rather than to explicitly detailed items of depreciable property. In most cases, a single industry guideline class will cover all the production machinery and equipment typically used in the industry. Certain assets in general use by all industries are covered by guideline classes which cut across industry lines. For most taxpayers three or four guidelines will encompass all of their depreciable assets.

The emphasis in this broad class approach is on achieving a reasonable overall result in measuring depreciation rather than a needless and labored item-by-item accuracy.

New Guidelines Immediately Available to All Taxpayers

Any taxpayer who wishes to use the new guideline lives, or a life longer than the guidelines, may do so initially as a matter of right and without question by the Internal Revenue Service for a period of 3 years. Use of guidelines will continue to be accepted thereafter unless there are clear indications that the taxpayer's replacement practices do not

conform with the depreciation claimed and are not even showing a trend in that direction.

Use of Lives Shorter Than Guidelines Permitted

The guideline lives will not be treated as minimums. Shorter lives which have already been established or which may in the future be justified as reflecting the taxpayer's existing or intended replacement practices will be permitted.

Thus the new Procedure will not disturb the continued use of below-guideline lives which a taxpayer has already demonstrated to be realistic.

Moreover, the Procedure sets forth standards under which taxpayers, including those previously using lives below the guidelines, may establish still shorter tax lives concurrent with the adoption of more progressive replacement and modernization practices.

Objective Standard Applied

An objective standard, the reserve ratio, is provided which a taxpayer may use, in addition to existing standards and procedures, to justify his use of a below-guideline life or his right to shift to even more rapid depreciation schedules. The reserve ratio also gives the taxpayer a continual means of demonstrating that the tax lives he is using correspond with his replacement pattern.

Reserve Ratio Test Not Exclusive

The reserve ratio test may be used by the taxpayer as a means of automatically justifying his right to follow whatever depreciation practices he is using. It will, however, be used only in conjunction with established standards as a

basis for imposing longer lives than those the taxpayer considers appropriate. Where the reserve ratio test is not met, the taxpayer will always be allowed, as at present, to demonstrate the reasonableness of the depreciation claimed on the basis of all the pertinent facts and circumstances.

Reserve Ratio Test an Overall Measure

The reserve ratio test measures the relationship between tax lives and replacement experience on a comprehensive basis with the objective of achieving a reasonable overall result.

Its use will therefore minimize preoccupation with determination of specific item lives, which can burden both taxpayers and the Internal Revenue Service without necessarily achieving meaningful improvement in the fairness or realism of depreciation allowances.

The reserve ratio test embodied in this Procedure differs significantly from the rough rules of thumb which have in the past sometimes been used. The appropriate ratios set forth vary according to the method of depreciation employed, the depreciable lives used and the rate of growth of a taxpayer's assets.

While the test is more carefully designed than former tests, it is, however, also more flexible. It takes into account the inevitable deviations from a theoretical norm by providing a range within which the reserve ratio may vary without signalling a possible need for adjustment of tax lives.

An important feature of the reserve ratio test is the latitude it allows taxpayers in the determination of their depreciable lives, provided they meet reasonable standards.

Appendix C

The margin of tolerance contained in the Reserve Ratio Table encompasses rates of replacement as much as 20 percent slower than the tax life used but only 10 percent faster. Thus the reserve ratio test will more quickly indicate the taxpayer's right to faster depreciation writeoffs than the possibility that longer tax lives should be used.

Rules for New Businesses and New Guideline Classes

New businesses will initially have no reserves against their assets, and it is therefore unlikely that they will have high reserve ratios during the first replacement cycle. As a consequence, new businesses will generally be permitted to use the guideline lives throughout the first replacement cycle. Thereafter, like any other business, they will be permitted to continue use of the guidelines, so long as replacement practice is consistent with the lives used.

Justification for use of below-guideline lives by new businesses will rest upon a showing of all the relevant facts and circumstances and use of such below-guideline lives, once justified, will likewise generally be permitted throughout one complete replacement cycle. The below-guideline life also may continue to be used by a new business, like any other, after the end of the first replacement cycle, so long as replacement practice is consistent with the tax lives being used.

In situations where the reserve ratio of a new business goes above the appropriate range, the taxpayer may justify the lives he is using on the basis of all the relevant facts and circumstances.

These same rules also apply to newly-established guideline classes of older businesses.

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Since the depreciation reserve of a new business or new guideline class is initially zero and will, therefore, remain relatively low for a period of years, existence of a low reserve ratio in a new business or new guideline class cannot be used, during the first replacement cycle, as automatic justification for movement to a life shorter than the one currently used.

Other situations in which the reserve ratio may not be a meaningful test include cases where it fluctuates widely because the guideline class contains relatively few assets, which are retired at irregular intervals. In these situations, a low reserve may not be used to justify a shorter life and a high reserve may not necessarily indicate that replacement practices are inconsistent with the lives used. Examination of all the facts and circumstances is then called for.

Penalty Rates Will Not Be Imposed

Where the taxpayer's replacement practice proves to be substantially out of line with the depreciation claimed, adjustments will be called for. The Procedure provides tables which will indicate how much adjustment is appropriate. The lives will be lengthened to correspond to the actual replacement practice of that business. "Penalty rates" which have in the past been used in an attempt to correct past errors over a brief span of time will no longer be imposed.

Use of New Guideline Classes Not Mandatory

While conversion of taxpayer depreciation accounts to the new guideline classes will facilitate administration of depreciation, taxpayers will not be required to change their

bookkeeping systems in order to use the new Procedure. A taxpayer who chooses to retain item accounts but who also wishes to use the new Procedure will be required merely to identify those items according to the guideline classes. Those who wish to use the new Procedure but also to retain multiple-asset accounts which do not correspond to the guideline classes will need to furnish IRS with sufficient information to permit comparison of the lives used with those set forth in the guideline classes.

A taxpayer may, if he desires, simply choose to have his depreciation claims examined under the procedures used in the past.

The administrative revision of depreciation guidelines and practices contained in this Procedure is based on a recognition that depreciation reform is not something which can be accomplished once and for all time. It reflects an administrative policy dedicated to a continuing review and up-dating of depreciation standards and procedures to keep abreast of changing conditions and circumstances.

RULES FOR APPLICATION

The fundamental concept underlying the new Procedure is that the depreciation claimed will not be disturbed if the taxpayer's retirement and replacement practices are consistent with the life used.

The reserve ratio test provides a technique for establishing the consistency between the tax life used and the subsequent retirement and replacement policy of the taxpayer.

Appendix C

Taxpayers who wish to use the new guideline lives or any life longer than the guidelines may do so without challenge for the first 3 years under this Procedure.

Taxpayers who have, in the past, been following replacement practices consistent with the tax lives previously used and who continue to follow practices consistent with the new lives claimed will automatically meet the reserve ratio test. They will, therefore, be allowed to continue indefinitely to use tax lives at least as short as the guidelines.

In those exceptional situations where the taxpayer's depreciation reserve is initially above the appropriate range for the guideline life or rises above that range during the first 3 years, he will nevertheless be allowed to continue to use a life at least as short as the guideline for a 3-year transition period.

The new lives may be questioned beginning in the fourth year only if the use of the objective reserve ratio test shows that he is not, in fact, moving toward a replacement practice consistent with the tax life used. Movement toward a consistent retirement and replacement pattern will be considered to be demonstrated if the amount by which the taxpayer's reserve ratio exceeds the appropriate range is lower than in any 1 of the 3 preceding years. If a taxpayer with an initially excessive reserve meets this test in the fourth year and does so continuously each year thereafter, he will be permitted a period of years equal to the guideline life to reach the upper limit of the appropriate reserve ratio range. For example, if a taxpayer is using a 12-year guideline life, he would be allowed a period of 12 years, beginning with the first year under this Procedure, to reduce his reserve ratio to within the range.

Appendix C

A taxpayer who has previously used lives shorter than the guidelines will be permitted *automatically* to continue to use these shorter lives if:

- He has previously demonstrated his right to such shorter lives, or
- He has used these lives for at least one-half of a replacement cycle and his reserve ratio falls within the appropriate range.

It is necessary that lives be in use for one-half a replacement cycle before the reserve ratio test may be used as automatic justification for below-guideline lives because this test may not reliably indicate whether shorter lives are justified when the life used has only recently been adopted.

The same transition and reserve ratio rules which apply to the taxpayer using the guideline lives will also apply thereafter to the taxpayer who justifies shorter than guideline lives on the basis of prior usage.

A taxpayer who wishes to move for the first time to a below-guideline life or to reduce further an already below-guideline life will be allowed to so *automatically* if:

- His reserve ratio for the preceding taxable year is below the lower limit of the appropriate reserve ratio range, and
- He has been using the life which he now wishes to reduce for at least one-half a full replacement cycle, and
- The new life to which he wishes to move is no lower than the life which can be justified by the use of the Adjustment Table which is provided as part of the new Procedure.

The transition and reserve ratio rules applicable in other situations are similarly available thereafter to the taxpayer

who moves for the first time to a below-guideline life or reduces an already below-guideline life.

Taxpayers who do not meet the prescribed tests for automatic use of lives shorter than those prescribed in the guidelines, regardless of whether or not they have used them previously, may in all cases demonstrate their entitlement to such shorter lives on the basis of all the relevant facts and circumstances.

Relevant facts and circumstances include, but are not limited to, demonstration that:

- The taxpayer (if other than a regulated public utility) is using the same depreciable life on his books as the one he is claiming for tax purposes.
- The taxpayer actually intends to follow a more rapid replacement practice.
- The taxpayer has previously followed replacement practices consistent with the depreciation allowances previously claimed.
- The taxpayer makes abnormally intensive use of his assets.
- A number of the assets in a guideline class were not new when acquired by the taxpayer.
- The guideline class contains, for the particular taxpayer, a disproportionate number of relatively short-lived assets.
- Extraordinary obsolescence affects the particular taxpayer.

Taxpayers will not be required to disturb their present depreciation accounts to qualify for the new guidelines and if they so desire may continue their present methods of justifying their depreciation deduction without regard to this Procedure.

The comparison of the lives used by the taxpayer with the guideline lives will be facilitated if the taxpayer's depre-

ciation accounts correspond to the guideline classes. Any taxpayer who is depreciating his assets in item accounts, or in multiple-asset accounts which do not correspond to the guideline classes, may therefore wish to regroup his assets for tax purposes in accounts corresponding to the guideline classes. However, he is not required to do so.

Even if a taxpayer does not regroup his assets in depreciation accounts corresponding to the guideline classes, he may qualify for the benefits of the new Procedure by merely regrouping his assets annually for purposes of applying these rules.

In any event, the taxpayer will always have the option of having his depreciation allowances examined under presently established practices, in the light of all the facts and circumstances, without regard to this new Procedure.

The reserve ratio test, which provides an objective basis for comparing the tax lives used and replacement practice, is computed as follows:

- The reserve ratio is determined by dividing the depreciation reserve for a particular class of assets by the original cost or other basis of these assets.
- The rate of growth of the guideline class is generally ascertained by first computing the ratio of assets in the class at the close of the current year to the assets in the class one replacement cycle earlier. The taxpayer can then read his rate of growth from the table provided in this Procedure
- The appropriate "test life" is then found. This is:
  - The guideline life—if he uses a life equal to or longer than the guideline.
  - The life previously justified—where the taxpayer uses a below-guideline life which is equal to or longer than the life previously justified.

• The life used in the preceding year—where the taxpayer wishes to establish a below-guideline life shorter than he has previously used.

• The life used in the current year—where the taxpayer wishes to justify use of the life he has been using for half a cycle.

• The life to which he has been lengthened—in all cases where an upward adjustment has been made.

• The reserve ratio is then compared with the reserve ratio range selected from the Reserve Ratio Table which is appropriate to the method of depreciation being used for the assets in that class, the rate of growth in the class and the test life for that class.

Upward adjustment in depreciable lives, where necessary, will be made in accordance with specified rules.

Where a depreciable life used by a taxpayer cannot be justified under any of the standards provided in this Procedure, including the reserve ratio test and use of all pertinent facts and circumstances, the life will be lengthened in accordance with definite rules. However, the life will in no case be lengthened beyond the shortest life which can be justified by all the facts and circumstances. The adjusted life will be designed to reflect the taxpayer's current replacement practice for that class. Penalty rates will not be imposed to compensate for excess depreciation taken in the past.

• The class life will be lengthened in accordance with the Adjustment Table provided with this Procedure, and may be read directly from that table, where the life being lengthened is equal to or longer than the guideline or in other situations where the reserve ratio test is an appropri-

ate measure of the conformity between depreciable life and replacement practice.

• The class life will be lengthened to the shortest life previously justified, or to the guideline life if no shorter life has been previously justified, in cases where a below-guideline life was used and the reserve ratio test is inappropriate. In the unusual case where a below-guideline life has been adjusted but the taxpayer still fails to meet the reserve ratio test, even after adjustment, further adjustment may be made in accordance with the Adjustment Table.

Necessary lengthening of depreciable lives will be effective beginning only with the year in which the reserve ratio test is not met and the life cannot be justified on the basis of the facts and circumstances. The lives will not be lengthened for any earlier taxable year.

This Procedure will be effective immediately but will not apply to depreciation allowances for taxable years for which returns were due to be filed before the date of publication of the Procedure.

Examination of the depreciation claimed for earlier taxable years will be made under previously established practices. The new guideline lives set forth in this Procedure will not be considered as evidence that these lives were the appropriate ones in previous years for a taxpayer who did not follow replacement practices consistent with the guidelines.

A taxpayer may, however, in certain circumstances resort to the Reserve Ratio Table in this Procedure to demonstrate that his replacement practice in past years supports the life claimed.

The new Procedure, overall, will provide more realistic and more uniform treatment of depreciation.

Appendix C

It will protect taxpayers from frequent adjustments in depreciation rates and will minimize needless controversy over the timing of the recovery of the cost of investment.

The experience under the new guideline lives, industry and asset classifications and administrative procedures will be watched carefully with a view to possible corrections and improvements. Periodic reexamination and revision will be essential to maintain tax depreciation treatment which is in keeping with modern industrial practices.

SECTION 4 OF THE NATURAL GAS ACT

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file

with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing

and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect, and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. June 21, 1938, c. 556, § 4, 52 Stat. 822; May 21, 1962, Pub. L. 87-454, 76 Stat. 72.

Appendix C

SECTION 7 OF THE NATURAL GAS ACT

CONSTRUCTION, EXTENSION, OR ABANDONMENT OF FACILITIES; CERTIFICATE OF CONVENIENCE AND NECESSITY; CONDEMNATION PROCEEDINGS

(a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided*, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly; *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve

particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Com-

mission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization.

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

(h) When any holder of a certificate of public convenience and necessity cannot acquire by contract, or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: *Provided*, That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000. June 21, 1938, c. 556, § 7, 52 Stat. 824; Feb. 7, 1942, c. 49, 56 Stat. 83; July 25, 1947, c. 333, 61 Stat. 459.

Appendix C

Sections 2553, 2554, 2555, 2556, and 2577 of the West Virginia Code of 1961 (Mitchie's)

§ 2553. [1] *Jurisdiction of Commission.*—The jurisdiction of the commission shall extend to all public utilities in this State, and shall include any utility engaged in any of the following public services:

Common carriage of passengers or goods, whether by railroad, street railroad, motor or otherwise, by express or otherwise, by land, water or air, whether wholly or partly by land, water or air; transportation of oil, gas or water by pipe line; sleeping car or parlor car services; transmission of messages by telephone, telegraph or radio; generation and transmission of electrical energy by hydroelectric or other utilities for service to the public, whether directly or through a distributing utility; supplying water, gas or electricity, by municipalities or others; sewer systems servicing twenty-five or more persons or firms other than the owner of the sewer systems; toll bridges, wharves, ferries; and any other public service. (1913, c. 9, § 3; 1915, c. 8, § 3; 1921, c. 150, § 3; Code 1923, c. 15-O, § 3; 1943, c. 73; 1945, c. 127.)

§ 2554. [2] *General Power of Commission to Regulate Public Utilities.* — The commission is hereby given power to investigate all rates, methods and practices of public utilities subject to the provisions of this chapter; to require them to conform to the laws of this State and to all rules, regulations and orders of the commission not contrary to law; and to require copies of all reports, rates, classifications, schedules and timetables in effect and used by such utility or other person, to be filed with the commission, and all other information desired by the commission relating to such investigation and requirements, including inventories

of all property in such form and detail as the commission may prescribe. The commission may compel obedience to its lawful orders by mandamus or injunction or other proper proceedings in the name of the State in any circuit court having jurisdiction of the parties or of the subject matter, or the supreme court of appeals direct, and such proceedings shall have priority over all pending cases. The commission may change any intrastate rate, charge or toll which is unjust or unreasonable or any interstate charge with respect to matters of a purely local nature which have not been regulated by or pursuant to act of Congress and may prescribe such rate, charge or toll as would be just and reasonable, and change or prohibit any practice, devise or method of service in order to prevent undue discrimination or favoritism between persons and between localities and between commodities for a like and contemporaneous service. But in no case shall the rate, toll or charge be more than the service is reasonably worth, considering the cost thereof. Every order entered by the commission shall continue in force until the expiration of the time, if any, named by the commission in such order, or until revoked or modified by the commission, unless the same be suspended, modified or revoked by order or decree of a court of competent jurisdiction. (1913, c. 9, § 5; 1915, c. 8, § 5; Code 1923, c. 15-O, § 5; 1935, c. 115.)

§ 2555. [3] *General Power of Commission with Respect to Rates.*—The commission shall have power to enforce, originate, establish, change and promulgate tariffs, rates, joint rates, tolls and schedules for all public utilities except carriers by vehicles over streets and roads, including municipalities supplying gas, electricity or water. And whenever the commission shall, after hearing, find any exist-

ing rates, tolls, tariffs, joint rates or schedules unjust, unreasonable, insufficient or unjustly discriminatory or otherwise in violation of any of the provisions of this chapter, the commission shall by an order fix reasonable rates, joint rates, tariffs, tolls or schedules to be followed in the future in lieu of those found to be unjust, unreasonable, insufficient or unjustly discriminatory or otherwise in violation of any provisions of law, and the said commission, in fixing the rate of any railroad company, may fix a fair, reasonable and just rate to be charged on any branch line thereof, independent of the rate charged on the main line of such railroad. (1915, c. 8, § 22; Code 1923, c. 15-O, § 22.)

§ 2556. [4] *Procedure for Changing Rates.*—No public utility subject to this chapter shall change, suspend or annul any rate, joint rate, charge, rental or classification except after thirty days' notice to the commission and the public, which notice shall plainly state the changes proposed to be made in the schedule then in force and the time when the changed rates or charges shall go into effect. But the commission may enter an order suspending the proposed rate as hereinafter provided. The proposed changes shall be shown by printing new schedules, or shall be plainly indicated upon the schedules in force at the time, and kept open to public inspection: Provided, however, that the commission may, in its discretion, and for good cause shown, allow changes upon less time than the notice herein specified, or may modify the requirements of this section in respect to publishing, posting and filing of tariffs, either by particular instructions or by general order.

Whenever there shall be filed with the commission any schedule stating a change in the rates or charges, or joint rates or charges, or stating a new individual or joint rate

or charge or joint classification or any new individual or joint regulation or practice affecting any rate or charge, the commission shall have authority, either upon complaint or upon its own initiative without complaint, to enter upon a hearing concerning the propriety of such rate, charge, classification, regulation or practice; and, if the commission so orders, it may proceed without answer or other form of pleading by the interested parties, but upon reasonable notice, and, pending such hearing and the decision thereon, the commission, upon filing with such schedule and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, regulation, or practice, but not for a longer period than one hundred and twenty days beyond the time when such rate, charge, classification, regulation or practice would otherwise go into effect; and after full hearing, whether completed before or after the rate, charge, classification, regulation or practice goes into effect, the commission may make such order in reference to such rate, charge, classification, regulation or practice as would be proper in a proceeding initiated after the rate, charge, classification, regulation or practice had become effective: Provided, that if any such hearing and decision thereon cannot be concluded within the period of suspension, as above stated, such rate, charge, classification, regulation or practice shall go into effect at the end of such period. In such case the commission may require such public utility to enter into a bond in an amount deemed by the commission to be reasonable and conditioned for the refund to the persons or parties entitled thereto of the amount of the excess, plus interest at the rate of six per cent per annum, if such rates so put into effect are subsequently determined to be

higher than those finally fixed for such utility. No such accrued interest paid shall be deemed part of the cost of doing business in a subsequent application for changing rates or any decision thereon. At any hearing involving a rate sought to be increased or involving the change of any fare, charge, classification, regulation or practice, the burden of proof to show that the increased rate or proposed increased rate, or the proposed change of fare, charge, classification, regulation or practice is just and reasonable shall be upon the public utility making application for such change. When in any case pending before the commission all evidence shall have been taken, and the hearing completed, the commission shall, within three months, render a decision in such case.

Where more than twenty members of the public are affected by a proposed change in rates, it shall be a sufficient notice to the public within the meaning of this section if such notice is published once a week for four consecutive weeks in some newspaper of general circulation in the community where the majority of the resident members of the public affected by such change reside or, in case of non-residents, have their principal place of business within this State. (1913, c. 9, § 9; 1915, c. 8, § 9; 1921, c. 130, § 9; Code 1923, c. 15-O, § 9; 1953, c. 152.)

§ 2577. [1] *Review of Final Orders of Commission.* — Any party feeling aggrieved by the entry of a final order by the commision, affecting him or it, may present a petition in writing to the supreme court of appeals, or to a judge thereof in vacation, within thirty days after the entry of such order, praying for the suspension of such final order. The applicant shall deliver a copy of such petition to the secretary of the commission before presenting the same to

the court or the judge. The court or judge shall fix a time for the hearing on the application, but such hearing, unless by agreement of the parties, shall not be held sooner than five days after its presentation; and notice of the time and place of such hearing shall be forthwith delivered to the secretary of the commission, so that the commission may be represented at such hearing by one or more of its members or by counsel. If the court or the judge after such hearing be of the opinion that a suspending order should issue, the court or the judge may require bond, upon such conditions and in such penalty, and impose such terms and conditions upon the petitioner, as are just and reasonable. For such hearing the commission shall file with the clerk of said court all papers, documents, evidence and records or certified copies thereof as were before the commission at the hearing or investigation resulting in the entry of the order from which the petitioner appeals. The commission shall file with the court before the day fixed for the final hearing a written statement of its reasons for the entry of such order, and after arguments by counsel the court shall decide the matter in controversy as may seem to be just and right. (1913, c. 9, § 16; Code 1923, c. 15-O, § 16.)

SUPREME COURT, U. S.

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FILED
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No. 527

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED FUEL GAS COMPANY,
Appellant,

—against—

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

MOTION TO DISMISS OR AFFIRM

ROBERT L. STEWART
Attorney for Appellee.
E-214 State Capitol
Charleston 5, West Virginia

January 15, 1964.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED FUEL GAS COMPANY,
Appellant,

—against—

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

Motion to Dismiss or Affirm

Comes now appellee and hereby moves the Court to dismiss the appeal herein or affirm the decision and judgment of the Supreme Court of Appeals of the State of West Virginia, from which decision and judgment said appeal was taken.

I. Brief Statement of Facts

United Fuel Gas Company is a West Virginia public utility with its main office and most of its facilities in the state of West Virginia. It has been engaged in the gas business in West Virginia for sixty years and

its West Virginia intrastate operations have been subject to the jurisdiction of the Public Service Commission of West Virginia for fifty years. Until after World War II, United Fuel produced or purchased its gas in West Virginia and Kentucky for markets in West Virginia and surrounding states.

After World War II a tremendous increase in the demand for gas, mostly in the company's interstate markets, and a decline in the production of Appalachian gas made it necessary for United Fuel to seek new gas supplies in the Southwest. In addition to other sources, it contracted to purchase large quantities of gas in Louisiana and contracted with Gulf Interstate Transmission Company (now Columbia Gulf, an affiliate) to transport that gas to United Fuel's facilities in West Virginia. In return for the transportation of the gas, United Fuel pays the cost of service of Columbia Gulf. This Louisiana gas, together with other Southwest gas, now constitutes more than 80 per cent of the gas supply of United Fuel Gas Company. During peak periods this Louisiana gas is sent directly to market. During summer periods it is delivered to various underground storage fields in West Virginia for withdrawal to meet the higher winter demand.

Although United Fuel now gets more than 80 per cent of its gas from the Southwest, it is still true that it purchases and produces more gas in West Virginia than it sells to West Virginia customers. United Fuel says, "Eighty per cent of the gas consumed by West Virginia customers originates in the Southwest" (Jurisdictional Statement, page 5), but it would be more accurate to say that the West Virginia customer

is charged as though 80 per cent of the gas came from the Southwest.

The truth is that nobody knows how much of the gas consumed in West Virginia is produced in West Virginia and how much comes from the Southwest. We do know that some of United Fuel's West Virginia customers sitting virtually on top of a gas well pay for their gas as though 80 per cent of it came from the Southwest. However, since United Fuel's gas supply from all sources is intermingled in such a way that it is impossible to tell who is served by what gas, the West Virginia Commission adopts the solution usually used for such purposes and pools all of the gas and allocates the cost of it on the basis of usage.

Of the great quantities of gas now being funneled through West Virginia, local customers consume only about 8 per cent. It is true that during peak periods this percentage climbs to about 12 per cent. Almost all of the remaining 92 per cent of the gas goes to United Fuel's interstate customers and mostly to Kentucky Gas Transmission Company, Ohio Fuel Gas Company, Manufacturers Light and Heat Company, and Atlantic Seaboard, affiliates of United Fuel.

Since United Fuel's costs are incurred to serve both interstate and intrastate customers, since its facilities are used to serve both interstate and intrastate customers, and since it is impossible, accurately, to segregate those costs and facilities between interstate service and intrastate service, it is necessary to allocate the costs. The West Virginia Commission considers that such allocation should be made on the basis of use. We understand that that is, in general, the method used

by the Federal Power Commission and other regulatory agencies.

It is commonly considered that costs in the gas business may be divided between those incurred for and associated with the procuring and delivery of annual volumes of gas (usually called "commodity costs") and those additional costs associated with meeting peak-period demands (called "demand or capacity costs"). Some costs fall neatly into one or the other category. Other costs have both elements in them. The latter costs, by what has come to be known as the "Atlantic Seaboard Formula," developed by the Federal Power Commission, are assigned (or "classified") 50 per cent to demand and 50 per cent to commodity. Both the West Virginia Commission and the Federal Power Commission follow, in general, the Atlantic Seaboard Formula in the classification and allocation of costs between jurisdictions. Commodity costs are allocated on the basis of annual sales while demand costs are allocated on usage during a three-day sustained peak period.

On May 1, 1962, Case No. 5536 was instituted before the Public Service Commission of West Virginia by the filing by United Fuel of a tariff stating increased rates and charges for its gas service in West Virginia. The tariff was suspended until October 2, 1962, and hearings were held on August 27 through August 30, 1962.

Of all the complex steps necessary in the classification and allocation of United Fuel's costs, only one resulted in substantial controversy at the hearing. The Commission's staff took the position that the costs

which United Fuel paid to Columbia Gulf for transporting gas from Louisiana should be classified 100 per cent to commodity. United Fuel insisted that the costs should be split about 50 per cent to demand and 50 per cent to commodity. After considering evidence that Columbia Gulf operated at 97 per cent of capacity during the test period and that during its peak day when it was operating at overload conditions it delivered only about 10 per cent more than it did on an average day, the Commission decided that these costs should be classified 100 per cent to commodity, the same as the purchase costs for the same gas in Louisiana, concededly a commodity cost.

At the hearings counsel and consultants for the protestant cities pointed out that under the new Guidelines Procedures promulgated by the Internal Revenue Service, United Fuel had available to it additional depreciation deductions which would decrease its tax liability. United Fuel declined to say whether or not it was going to use the new Guidelines Procedures in calculating its federal income tax. Pointing out that the company did not state any reason for not using them nor any way in which it might be adversely affected by using the new rates, the Commission decided to compute United Fuel's cost of service by considering the Guidelines rates in connection with the income tax allowance. By order entered on October 17, 1962, the Public Service Commission of West Virginia approved intrastate rates for United Fuel Gas Company designed to increase its revenues by $361,104.00.

After the entry of the Commission's final order and in the light of it, United Fuel, for the first time, said, in its petition for rehearing, that it did not plan to use

the depreciation rates provided for by the Guidelines Procedures. By order entered by the Commission on December 13, 1962, the Commission refused to reopen the proceeding.

Both United Fuel and the protestant cities petitioned the Supreme Court of Appeals of West Virginia to review and set aside the orders of the Public Service Commission, United Fuel because the rates were too low and the cities because the rates were too high. After the filing of briefs and the oral arguments of counsel, the Court denied both petitions. United Fuel Gas Company appeals to this Court from the order of the Supreme Court of Appeals of West Virginia denying its said petition.

II. No Conflict Between the Order of the West Virginia Commission and any Order of the Federal Power Commission Exists.

The inescapable inference which anyone not intimately acquainted with the facts would draw from United Fuel's jurisdictional statement filed with this Court is that the West Virginia Commission has decided that the Columbia Gulf costs should be classified 100 per cent to commodity and the Federal Power Commission has decided that they should be classified about 50 per cent to demand and 50 per cent to commodity. But that statement is simply not true. The truth is that the West Virginia Commission has decided to classify those costs 100 per cent to commodity, not once but three times, but that the Federal Power Commission had not decided the issue at all. Although United Fuel has constantly tried to becloud this issue before the Commission and before the Supreme Court

of Appeals and succeeded in leading Commissioner Townsend into the error mentioned on page 7 of the jurisdictional statement, the facts are clear and may be readily documented. United Fuel's knowledge of the facts readily appears from the record in this case itself. C. H. Workman, vice president of United Fuel and other Columbia companies, admitted on cross-examination that the Federal Power Commission had never decided this issue (Tr. p. 113).

All of United Fuel's rate cases before the Federal Power Commission in which gas transported by Gulf Interstate or Columbia Gulf has been involved have been settled rather than decided. These settlements were made at conferences of United Fuel, its customers, Federal Power Commission staff, and other intervenors, including the Public Service Commission of West Virginia. In each case the conferees agreed on a dollar cost of service without agreement on the principles underlying or supposed to underlie that cost of service.

In approving those settlements, the Federal Power Commission did not pass upon any issues or principles supposed to underlie the settlements. The FPC made this most strikingly clear in its order issued September 15, 1960, approving the settlement in Dockets Nos. G-12195, G-16316, G-16815 and G-18420 in which it said, "In issuing this order, the Commission's action is not to be construed as a concurrence with the cost of service determinations, allocation methods and rate design principles used in arriving at rates and charges for future sales, or in computing the amounts of refunds agreed upon in the settlement agreement, and neither the Commission, its staff, or the parties to the proceed-

ings are to be prejudiced or bound thereby in future proceedings." The Commission's order dated October 19, 1956, in Dockets Nos. G-2451 and G-5475 (16 FPC 1069) is to the same effect. The order entered in *United Fuel Gas Company*, Docket No. G-20270, on March 20, 1962, says, "This order is without prejudice to any findings or orders which have been or may be made hereafter by the Commission, and is without prejudice to claims or contentions which may be made by the Commission, United Fuel, the Commission's staff, or any affected party herein, in any proceeding now pending or hereafter instituted by or against United Fuel or any other companies, persons, or parties affected by this order."

It is in this context that United Fuel tells this Court that there has been a determination by the Federal Power Commission of the question of the proper classification of the costs which United Fuel pays to Columbia Gulf Transmission Company, resulting in a conflict between the Public Service Commission of West Virginia and the Federal Power Commission.

It is quite true that in preparing cost-of-service studies for settlement conference purposes in those rate cases the Federal Power Commission's staff classified the Columbia Gulf costs approximately 50 per cent to demand and 50 per cent to commodity. But, as pointed out above, the classification was neither litigated nor agreed. It should be apparent that the West Virginia Commission would not agree to one method of classification before the Federal Power Commission while adopting another for the same company in West Virginia.

Nor can it be demonstrated that the dollar gap of which United Fuel complains actually exists. First of all, the cost-of-service figures arrived at by using the fifty-fifty classification of Columbia Gulf costs was adjusted upward to arrive at the settlement figures, and, secondly, different test periods have always been used for the cases before the Federal Power Commission and those before the West Virginia Commission. Use of these different test periods has resulted in different allocation factors being applied by the different commissions. By coincidence or otherwise, adding the allocation factors for interstate business used in the Federal Power Commission case to the allocation factors for West Virginia business used in the closest West Virginia case and those allocation factors for business under the jurisdiction of neither commission, has usually resulted in more than a hundred per cent.

We, of course, cannot say how the Federal Power Commission will decide this issue in some future case. We feel sure that the FPC would decide it on the record before it, after giving due consideration to the conflicting views of all parties, including the West Virginia Commission. We cannot even say how the West Virginia Commission, in some future case, upon a different record, and perhaps with different commissioners, would decide the issue. We can only say that to this point there has been no conflict on this issue between any order of the West Virginia Commission and any order of the Federal Power Commission.

There has been a head-on collision on this question of classification between the West Virginia Commission and the United Fuel Gas Company, but such a conflict hardly presents a federal question proper for con-

sideration by this Court, nor does a difference of opinion between the West Virginia Commission and some members of the Federal Power Commission staff. These questions of cost allocation are questions of fact—not law. *Colorado Interstate Gas Co.* v. *Federal Power Comm.* (1945), 324 US 581, 65 Sup Ct 829.

III. The Commission's Decision on Federal Income Tax Allowance does not Conflict with any Federal Law.

United Fuel discusses the Commission's decision to compute the federal income tax allowance for United Fuel by using the additional depreciation deductions available to it under the Guidelines Procedures as though that decision were reached after United Fuel had stated that it was not going to use those Guidelines Procedures. The truth is that on the record in Case No. 5536 the company refused to say whether or not it would use such Guidelines depreciation rates and did not announce that it did not plan to use them until after the entry of the Commission's final order of October 17, 1962. In a petition for rehearing in connection with such order and in the light of that order, United Fuel, for the first time, announced that it did not plan to use the increased depreciation rates. The facts shown by the record were that the Guidelines depreciation rates were available to United Fuel and that United Fuel might or might not use them in preparing its income tax returns.

On this issue the company is asking this Court to do no less than to try this issue *de novo* on the basis of matters which were not presented in evidence and which have a status no higher than that of self-serving declarations.

The West Virginia Commission, on the other hand, insists that its decision on this issue should be treated by no other standard than the information properly available to it before the entry of the order complained of. The elements adduced at the hearing showed that there was available to United Fuel an income tax deduction for depreciation substantially in excess of that used in the test period as the result of new regulations by the Internal Revenue Service, commonly referred to as "Guidelines Procedures"; that those depreciation rates were available to the company without penalty for at least three years; that no way in which the company could be hurt within the foreseeable future by using those Procedures had been shown; and that the company, for good reasons or bad, took no position on whether or not it would use the Guidelines rates, saying that it would not know for several months, a period longer than the Commission could wait for the answer.

The Commission was thus faced with two alternatives: 1) It could use the depreciation rates available under the Guidelines Procedures and run the risk that the company would say it did not intend to use them, that the action of the Commission was arbitrary and capricious, and that its property was being confiscated —exactly what happened; or 2) it could ignore the availability of the additional depreciation deductions and run the risk that the company would use them and recover from the customers an allowance for income taxes never actually paid. In the first case, assuming that the decision of the Commission was not disturbed by the courts, the company would either have to use the Guidelines rates or accept the loss for not using them until it could, in a rate case, persuade the Commission to change its position, if in fact it could. If the

second alternative were followed, the consumers might have to pay rates sufficient to include these "phantom taxes" for whatever time the rates approved in this proceeding were in effect, without any recourse or remedy whatsoever. The two alternatives hardly seem comparable at all. In view of the additional fact that a utility is under a duty to keep the cost of its service to the public as low as it reasonably can, the Commission decided to resolve the doubt in favor of the public and to use the Guidelines rates.

Section 4, Article 2, Chapter 24 of the 1931 Code of West Virginia, as amended (Serial Section 2556), provides in part, "At any hearing involving a rate sought to be increased or involving the change of any fare, charge, classification, regulation or practice, the burden of proof to show that the increased rate or proposed increased rate, or the proposed change of fare, charge, classification, regulation or practice is just and reasonable shall be upon the public utility making application for such change." This burden of proof extends not only to the overall case but also to the constituent elements thereof. *Natural Gas Co.* v. *Public Service Comm.*, 95 W. Va. 557, 121 SE 716. This position is also supported by *Lindheimer* v. *Bell Telephone Co.* (1934), 292 US 151, 54 Sup Ct 658.

Certainly the burden is on a utility to prove the propriety of its claimed allowance for federal income tax as much as any other element of a rate case. Not only did the company fail to carry this burden, but it failed to take an unequivocal position on what it planned to do.

The West Virginia Commission did not deprive United Fuel of any of its rights under Section 167 of the Internal Revenue Code or under the Guidelines Procedures. Under those Procedures there was an election to be made which could change the federal income tax to be included in the cost of service by a substantial amount. United Fuel failed and refused to make that election during the time the Commission was considering the case. All that the Commission did in its final order was to make the election for United Fuel insofar and only insofar as the West Virginia rate case was concerned.

We feel that the West Virginia Commission's decision on this point was the only acceptable choice between the alternatives available to it on the record. Nor do we think that it would have been proper for the Commission to have reopened the proceeding and changed its decision on the depreciation question based on information submitted for the first time in the petition for rehearing. If a company were permitted to withhold information or refuse to take a position until after the Commission's order and then, in the light of that order, present the information or take the position and on that basis ask for a reconsideration of the order, there would be no end to the mischief that would result. At any rate, whether the Commission's decision was right or wrong, there is no conflict between it and the Internal Revenue laws or any regulations issued under them.

It is, therefore, submitted that there is no conflict between the order complained of and any order of the Federal Power Commission; that there has been no interference by the West Virginia Commission with

the flow of gas in interstate commerce; that the Commission's findings were not arbitrary but were based on evidence; that the utility has been given a fair hearing and has failed to carry the burden of proof and has failed to overcome the legal presumption of the validity and correctness of the order herein involved, and this being true, has failed to show the existence of a substantial federal question.

Appellee, Public Service Commission of West Virginia, contends that the record in this case discloses no substantial federal question and, therefore, this Court is without jurisdiction of this cause. It is, therefore, submitted that appellee's motion herein to dismiss the appeal or affirm the judgment of the Supreme Court of Appeals of West Virginia should be granted. Wherefore appellee prays that this Court refuse to note jurisdiction of this cause and that appellee's motion to dismiss the appeal or affirm the judgment be granted.

ROBERT L. STEWART
Attorney for Appellee.

January 15, 1964

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 527

UNITED FUEL GAS COMPANY, APPELLANT

v.

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

MEMORANDUM FOR THE UNITED STATES AND FEDERAL POWER COMMISSION, AMICI CURIAE

The present appeal is from a judgment of the Supreme Court of Appeals of the State of West Virginia, entered on May 20, 1963, and amended on May 29, 1963, denying appellant's petition for review of final orders of the Public Service Commission of West Virginia.

The Solicitor General, pursuant to this Court's order of December 16, 1963, submits this memorandum setting forth the government's views on the issues presented in the appellant's jurisdictional statement.

QUESTIONS PRESENTED

1. Has the appellant, United Fuel Gas Company, raised any substantial federal question under the Supremacy Clause, the Commerce Clause, or the Due Process Clause by showing that the Public Service Commission of West Virginia, in developing and establishing rates for the portions of appellant's utility business subject to State jurisdiction, employed a rate-making technique different from the technique used by the Federal Power Commission in evaluating and approving appellant's rates for portions of its business subject to federal jurisdiction.

2. Has appellant demonstrated any conflict between the orders of the Public Service Commission of West Virginia and Section 167 of the Internal Revenue Code; did that Commission misapprehend Revenue Procedure 62–21 issued under Section 167?

STATEMENT

The appellant, United Fuel Gas Company (United Fuel), sells natural gas in West Virginia and in other States. Substantially all of its sales, except those at retail in West Virginia, are made in interstate commerce for resale, at rates approved by the Federal Power Commission pursuant to the Natural Gas Act, 15 U.S.C. 717–717w. The retail sales in West Virginia are made at rates approved by the Public Service Commission of West Virginia pursuant to Sections 2553–2556 of the West Virginia Code of 1961 (Michie's).

Both the Federal Power Commission and the West Virginia Commission rely on cost-of-service studies

in fixing rates designed to meet the standards of their respective statutes.[1] Cost-of-service reflects the regulated company's entire cost of doing business. In addition to direct expenses for such items as labor, purchased gas, taxes, and maintenance, the company is also allowed a return of capital through depreciation charges and a return on the unrecouped capital which is derived by the application of a fair rate of return to the company's prudent-investment rate base.

When a company uses the same facilities—as does United Fuel—to render services regulated by more than one jurisdiction, it becomes necessary for the respective regulatory commissions to determine what portion of the company's total cost of service is related to the service rendered in their respective jurisdictions. *Minnesota Rate Cases*, 230 U.S. 352, 435. In the case of natural gas pipeline companies, it has long been the practice to make this determination by allocation of costs. *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U.S. 581, 586. No jurisdictional line is drawn across the physical properties themselves; rather, the costs are allocated on the basis of the ratio of jurisdictional service to the total service rendered.

Before such an allocation is possible, however, it is necessary to classify costs in order to associate them with the type of service rendered. For this purpose, service is normally considered to be of two types—

[1] "Just and reasonable," Natural Gas Act, Section 4(a); 15 U.S.C. 717c(a); "Reasonable," West Virginia Code of 1961 (Michie's), Section 2555.

peaking and annual. The distinction results from the fact that although two customers may take exactly the same amount of gas on an annual basis, one may be willing to be "cut off" (or be denied gas) during the peak periods of demand on the pipeline, while the other may be in particular need of gas at that time.[2] In order to be assured of peaking service, a customer pays what is known as a demand charge. In addition, all customers pay a commodity charge based upon the total amount of gas they consume. For the purpose of computing these charges, certain cost items are classified as demand costs, others as commodity costs; still others are classified as both commodity and demand, usually on a fifty-fifty basis.

Once the company's total costs have been classified as demand or commodity, jurisdictional allocations may be made within each classification. Demand costs are allocated among those customers who receive gas during the peak period, in proportion to each customer's purchases during that period. Commodity costs are allocated among all customers on the basis of their relative annual purchases.

It is the problem of cost classification which gives rise to the first of the two issues raised by the present appeal. United Fuel pays an affiliated company, Columbia Gulf Transmission Company, to transport gas owned by United Fuel from the Southwest (where it is produced) to the beginning of

[2] Typically, householders or commercial establishments will need to be assured that they can have maximum amounts of gas on the coldest winter days, while industrial users can switch to other fuels or close down their plants in such periods.

United Fuel's own transmission line. The Federal Power Commission, for the purpose of evaluating and approving a settlement with respect to United Fuel's interstate wholesale cost-of-service, has classified this transportation expense half to demand and half to commodity. Since during the test period used by the Federal Power Commission (the 12 months ended March 31, 1960) the interstate wholesale customers took 90.424% of United Fuel's annual gas volumes but only 88.274% of the peak period volumes,[3a] the classification of Columbia Gulf's transportation costs half to demand and half to commodity means that the interstate customers pay rates reflecting 89.3% of the test period Columbia Gulf expense.[3b]

The West Virginia Commission, on the other hand, classified the entire Columbia Gulf expense to commodity. Since the annual intrastate retail sales subject to regulation by the West Virginia Commission amounted to only 8% of United Fuel's total 1961 sales, the effect of this determination was to set the intrastate retail rates at a level calculated to recover only about 8% of Columbia Gulf's 1961 costs. The fact that some 12½% of United Fuel's peak period sales were to intrastate retail customers was thus not fully reflected in the rate set by the West Virginia Commission. It is this failure of the West Virginia

[3] Columbia Gulf, which, like United Fuel, is wholly-owned by the Columbia Gas System, has no function other than to transport gas for United Fuel.

[3a] 27 FPC at 544, line 10.

[3b] Cf. Jur. St., p. 6, where appellant mistakenly assumes that the interstate rates recoup 89.5% of the 1961 test period Columbia Gulf expense.

Commission to fix retail rates for United Fuel reflecting a classification of Columbia Gulf costs complementing that reflected by the wholesale rates fixed by the Federal Power Commission which forms the basis of appellant's first allegation of error.

The other issue is unrelated to any action by the Federal Power Commission[4] and stems from the issuance by the United States Department of the Treasury in 1962 of a document entitled Depreciation Guidelines and Rules (Rev. Proc. 62–21 (1962)), which listed for the natural gas pipeline industry, among others, the number of years which the Treasury indicated it might consider appropriate in determining the "useful lives" of various types of equipment for purposes of the depreciation provisions of Section 167 of the Internal Revenue Code. The useful lives so listed were shorter than those which the Treasury had previously indicated would be appropriate. Shorter lives mean more rapid depreciation. Thus, use of Guideline lives means higher depreciation charges, a correspondingly higher tax deduction for depreciation expense, and, as a result, a lower tax liability. These "Guideline lives" were not mandatory (Jur. St., p. 10c), and, while the Treasury announced that any taxpayer could utilize them without challenge for a period of three years, their subsequent use was to depend upon the taxpayer's actual replacement practice (*ibid.*).

[4] A related question as to the regulatory treatment of a company failing to avail itself of the Treasury Guidelines is now pending before the Federal Power Commission. The Commission expresses no view on this question. The opinions stated on Question 2 are those of the Solicitor General.

The West Virginia Commission, in fixing the federal income tax component of the cost-of-service for United Fuel, allowed a sum for the company's taxes based upon what the company would pay if it chose to utilize the Guideline useful life figures for its property. It did so despite the fact that United Fuel's witness had testified that the company had not decided whether to utilize the then newly-promulgated Guideline lives in lieu of the longer lives upon which it had hitherto calculated deprecation for tax purposes (R. 591). The position of the West Virginia Commission was (1) that a regulated utility is bound "to take advantage of all reasonable economies in the operation of its business and to pass on the savings therefrom to its customers," and (2) that United Fuel had failed to indicate that the use of Guideline lives would adversely affect the company (Jur. St., p. 16b). This determination is challenged by the appellant as being in conflict with Section 167 of the Internal Revenue Code and the Treasury Regulations promulgated thereunder.

DISCUSSION

1. Appellant challenges on three grounds the West Virginia Commission's failure to adopt a cost classification technique complementary to that which was utilized by the Federal Power Commission in approving appellant's interestate rate settlement, alleging that the State's determination (1) conflicts with the Supremacy Clause of Article VI of the United States Constitution; (2) constitutes an undue burden on inter-

state commerce, and (3) deprives appellant of its property without due process of law.

A. The contention that the West Virginia Commission is bound by the Supremacy Clause to follow the determinations of the Federal Power Commission with respect to the classification of particular costs incurred by a natural gas company in performing services subject to regulation by both agencies misconceives the regulatory scheme established by Congress in the Natural Gas Act. That enactment clearly distinguished between the areas of federal and State regulation. The Federal Power Commission was to have jurisdiction over the transportation and sale for resale of natural gas in interstate commerce; in all other areas—which, of course, embraces sales at retail—the States were to retain authority. The Shreveport Doctrine (see *Houston, East and West Texas Railway Co.* v. *United States,* 234 U.S. 342) was not written into the Natural Gas Act.

Since many natural gas companies have services falling within both the federal and State domains, disparities in the regulatory treatment of various facets of a company's business are a common occurrence. Thus the Federal Power Commission determines the rate base of natural gas companies on an original-cost-less-depreciation basis (see *Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591), whereas a number of States still adhere to "fair value" concepts (see Federal Power Commission, *State Commission Jurisdiction and Regulation of Electric and Gas Utilities,*

1960, p. 8). Similarly, the rate of return allowed by State Commissions in fixing intrastate retail rates often varies from that deemed appropriate by the Power Commission in prescribing the interstate wholesale rates of the same company.

Such deviations from the federal methods have never been thought offensive to the Supremacy Clause merely because the end result is that the company's total revenue will be less than if the federal example had been followed. The reason is that no federal statute directs how intrastate rates are to be regulated.

The situation presented here is essentially the same. The problem of determining what portion of a company's facilities or costs are properly assignable to its operations subject to federal regulation and what portion to those subject to State regulation is a difficult one. Nothing in the federal statute directs a State agency how to make cost allocations on matters within its jurisdiction.

The desirability of avoiding inconsistency in allocations makes the problem appropriate for joint federal-State cooperation. Thus in the communications field the Federal Communications Commission and the National Association of Railroad and Utility Commissioners ("NARUC") have agreed upon a "Separations Manual" which is usually, but not invariably, followed by the Communications Commission and the State agencies. See, *e.g., Re New England Telephone & Telegraph Company,* 97 PUR (NS) 410, 417 (New Hampshire Public Utilities Commission, 1952); *Re New York Telephone Company,* 91 PUR (NS) 231, 244 (New York Public Service Com-

mission, 1951). A similar joint effort has been initiated in the gas and electric power fields between the Federal Power Commission and NARUC. See Federal Power Commission, Forty-Second Annual Report, 1962, p. 76. But while uniformity may be advantageous as a matter of regulatory policy, diversity is not precluded by any principle of federal supremacy.

If the Federal Power Commission had asserted jurisdiction over a natural gas company or some of its operations pursuant to the procedures established by the Natural Gas Act (which provide for participation before the Commission and in subsequent court review by interested States or State agencies[5]), a State's attempt to compel a different course of action would raise questions under the Supremacy Clause. But here there is no dispute between the Federal Power Commission and the West Virginia Public Service Commission as to anything within either of their respective areas of responsibility over United Fuel's operations, and appellant does not suggest that either Commission is overstepping its jurisdictional bounds. The claim is solely that West Virginia, in performing a task admittedly within its jurisdiction, has failed to follow the methods utilized by the Federal Power Commission in carrying out its assigned task, and that this has resulted in United Fuel's recovering less than its full costs on an item of joint interest to the two agencies. Assuming, *arguendo*, that this indicates that one of the two agencies erred, it does not raise a question of federal supremacy be-

[5] See Natural Gas Act, Sections 4(e), 5(a) and 15(a), 15 U.S.C. 717c(e), 717d(a) and 717n(a).

cause neither the federal statute nor the federal agency lays down a mandate concerning the operations of the State agency.[6]

B. Nor do we agree with appellant's claim that the action of the West Virginia Commission constitutes an impermissible burden on interstate com-

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[6] The federal cost classification which appellant alleges was binding upon the West Virginia Commission was not even the product of any considered determination of that issue by the Federal Power Commission. The last formal Commission determination of United Fuel's interstate rates was in August, 1953, prior to the construction of Columbia Gulf's transmission facilities. *In the Matter of United Fuel Gas Co.*, 12 FPC 251; *cf. In the Matter of Gulf Interstate Gas Co.* 12 FPC 116. Since that time United Fuel's interstate wholesale rates have been determined as a result of rate settlements, the last of which, approved March 20, 1962, established United Fuel's present rates. See *United Fuel Gas Co.*, 27 FPC 538. While that order contains, as an Appendix A, a stipulated cost of service used for settlement purposes which reflects the classification of Columbia Gulf's transmission costs half to demand and half to commodity (27 FPC at 542, see, *e.g.*, line 29), the order also contains a statement that it is "without prejudice to claims or contentions which may be made by the Commission, United Fuel, the Commission staff, *or any affected party herein*, in any proceeding now pending or hereafter instituted by or against United Fuel." (*id.* at 541, emphasis added.) Significantly, the West Virginia Commission was a party to the Commission proceeding and to the settlement, and the West Virginia Commission had previously determined that the Columbia Gulf costs should be allocated 100% to commodity. Re *United Fuel Gas Company*, 27 PUR 3d 365, 375 (West Virginia Public Service Commission, 1959).

It seems clear, therefore (as appellant's witness recognized in the hearing before the West Virginia Commission, R. 126), that the Federal Power Commission has never expressly determined that the Columbia Gulf costs should be split between demand and commodity, and that West Virginia cannot be said to be bound by the details of the cost-of-service attached to the Federal Power Commission's settlement order.

merce. There may well be circumstances in which a State's action, otherwise within its proper sphere of jurisdiction, so impairs the ability of a natural gas company to carry out operations in interstate commerce that a substantial federal question is presented. Cf. *e.g., Northern Natural Gas Co.* v. *Kansas Commission,* 372 U.S. 84. But here there is no showing that this is the case. Cf. *Narragansett Electric Company* v. *Kennelly,* 143 A. 2d 709, 723 (Rhode Island Supreme Court, 1958). Certainly, the mere fact that United Fuel will derive lower gross revenues on the intrastate retail portion of its business than would have been the case if the West Virginia Commission had followed the Federal Power Commission's classification of the Columbia Gulf Transportation costs does not indicate that appellant's overall financial position will be significantly impaired, or that there would be any basis for seeking higher interstate rates. Where a State discriminates between intrastate and interstate concerns, or where, as in the *Northern* case, *supra,* the direct effect of the State action would be to change the gas purchasing patterns of the interstate pipelines, this Court may find it necessary to consider the substantiality of the burden the State action imposes on interstate commerce. But it obviously cannot be presumed that any State measure which limits the revenues from intrastate business of a company which also does an interstate business constitutes a burden on interstate commerce. There must be a demonstrable impact.

C. Finally, appellant invokes the Due Process clause, alleging that the West Virginia Commission's action was confiscatory. This Court has consistently

held that in rate cases this issue must be examined solely in terms of the validity of the end result—the rates themselves—and that it will not go behind a rate to examine the ratemaking techniques or methods used in its derivation. See *Los Angeles Gas and Electric Corp.* v. *Railroad Commission*, 289 U.S. 287, 304–305; *West Ohio Gas Co.* v. *Commission*, 294 U.S. 63, 70; *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602; *West* v. *Chesapeake & Potomac Telephone Co.*, 295 U.S. 662, 692–693 (dissenting opinion).

Here there is no claim that the rates set by the West Virginia Commission, considered by themselves, were confiscatory, or even that the classification method adopted by the State Commission was inherently unlawful. Nor is there a showing that the combined action of the State and federal commissions resulted in rates which prevented the company from recovering its costs or even from earning a fair return on its investment. United Fuel claimed merely that the resulting rates would yield it $800,000[7] less than it would have earned had the two commissions utilized the same method in classifying the Columbia Gulf expense. Since the company's rate base, as deter-

[7] The record does not support the $800,000 figure used by appellant (Jur. St., pp. 6-7). That figure assumes that United's interstate wholesale rates would recover only the same percentage of its payments to Columbia Gulf for gas transportation during 1961 (the West Virginia Commission's test year) as test year used in the settlement approved by the Power Com- during the earlier 12-month period ending March 31, 1960 (the test year used in the settlement approved by the Power Commission). If Columbia Gulf's costs have declined with the passage of time, as we believe they have, such an assumption is wholly unwarranted.

mined by the West Virginia Commission in the proceedings at issue here was $192,769,091 (R. 399), an annual reduction of $800,000 in gross revenues (or roughly $400,000 of revenue after taxes) is the approximate equivalent of a reduction of .2 of a percentage point in the rate of return.[8] The rates established by the Federal Power Commission, applicable to some 92% of the company's annual sales, were predicated upon a rate of return of 6.44%;[8a] the State Commission allowed 6%;[8b] and the weighted average of the two rates is 6.40%. Thus the net effect of the claimed $800,000 deficiency would have been to lower United Fuel's overall rate of return from 6.40% to 6.20%. In the absence of any showing that such a rate of return is not within the zone of reasonableness, the charge of confiscation must fail.

2. The second issue in this case involves a narrow aspect of one of the more controversial current problems of public utility rate-making—how to compute the federal income tax expense in a company's cost of service where the company may have an option to adopt one of the rapid-depreciation methods permitted by Sections 167 and 168 of the Internal Revenue Code. See, *e.g.*, *El Paso Natural Gas Co.* v. *Federal Power Commission*, 281 F. 2d 567 (C.A. 5), certiorari denied *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912; *Cities of Lexington, etc., Ky.* v. *Federal Power Comm.*, 295 F. 2d 109 (C.A. 4); *Panhandle Eastern Pipe Line Co.* v. *Federal Power Com-*

[8] $400,000 ÷ $192,769,091 = .002.

[8a] 27 FPC 542, lines 8, 13, and 18.

[8b] Jur. St., p. 19b.

mission, 316 F. 2d 659 (C.A.D.C.), certiorari denied, 375 U.S. 881; *Alabama-Tennessee Natural Gas Co.*, F.P.C. Opinion No. 417, Docket Nos. G–5471, *et al.*, issued Feb. 3, 1964. Specifically, the question here is whether the West Virginia Commission contravened the policy of the Revenue Code when it determined United Fuel's tax expense as though, contrary to fact, the company had elected to utilize the Guideline lives suggested by the Treasury in Revenue Procedure 62–21. Since the Guideline lives are considerably shorter than those presently used by the company, the effect of the Commission's action is to increase the depreciation deduction and thereby reduce the tax allowance in the company's cost of service. Although United Fuel advised the Commission that it had not yet decided whether to adopt the new procedure, the Commission held (Jur. St., p. 16b) that—

> The company has a duty to take advantage of all reasonable economies in the operation of its business and to pass on the savings therefrom to its customers. Since the record is devoid of any evidence showing that use of the new guideline rates would adversely affect United Fuel, the new depreciation rates will be used in computing the Company's income tax for inclusion in the cost of service.

United Fuel does not challenge the Commission's order on Fourteenth Amendment grounds. Its sole contention is that the order is repugnant to Section 167 of the Code in that it deprives the company of its statutory option to refrain from utilizing the new depreciation procedures made available by the Treasury.

We disagree with that contention: Nothing in the State Commission's order purports to control the tax returns filed or the taxes actually paid to the United States. The order merely computes rates as if the option to use the Guideline lives had been exercised. Nothing in the Treasury Regulation purports to give any options concerning the accounting methods used for the purposes of State rate regulation.

Nevertheless, we think that a federal question is raised because the State order appears to be based upon a misconstruction of the effect of the Treasury Regulation as a matter of federal law.

Revenue Procedure 62–21 is different from other forms of rapid depreciation permitted by Sections 167 and 168 of the Code. Pertinent portions of Section 167 permit larger deductions during the early years of the useful life of each plant unit than would be available under the conventional "straight-line" method of depreciation accounting, with resulting lesser percentages during later years. Section 168 permits deduction, in five equal annual installments, of investment in facilities certified as "emergency," thus writing off investment in those facilities much more rapidly than under "straight-line" accounting, with zero deductions during the remaining life of such facilities. Both of these techniques are freely available to all taxpayers without regard to their actual replacement practices. Where the Code provides such an option, it is in nowise inconsistent with the intent of Congress for a regulatory agency, State or federal, to require a public utility to take advantage of the

tax savings and pass them on to its rate-payers.[9] The mere fact that rapid depreciation procedures are not mandatory as a matter of federal tax law does not bespeak a congressional purpose to relieve taxpayers of their obligations under other federal statutes or under State law. In particular, there is no purpose to immunize public utilities from otherwise valid regulations requiring them to utilize available cost-savings opportunities.[10]

The Guideline lives, however, differ significantly from the liberalized depreciation methods referred to above in that they may be utilized, in the long run at least, only to the extent justified by the taxpayer's actual retirement practices. Thus, Revenue Procedure 62-21 expressly states that Jur. St., p. 6c)—

> A central objective of the new Procedure is to facilitate the adoption of depreciable lives

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[9] We express no view as to the wisdom of such action as a matter of regulatory policy.

[10] An analogy is found in the law of fiduciaries. Suppose, for example, that a testamentary trustee, operating a business on behalf of beneficiaries, elected not to claim rapid depreciation for tax purposes. The effect of that decision would be to forego a tax reduction in the short run, while avoiding a possible increase in future years when the assets are fully depreciated. The income beneficiaries might well complain that their interests had been improperly subordinated to those of the remaindermen, *i.e.*, that the trustee was obligated, under the terms of the will or under State law generally, to minimize taxes in the short run by claiming the maximum depreciation deduction. If the probate court, applying State law, were to order the trustee to adopt one of the rapid-depreciation methods permitted by the Revenue Code, no one would argue that the court's action was barred by the Supremacy Clause or that the trustee was somehow absolved of its fiduciary duty merely because the Revenue Code leaves the method of depreciation optional.

> even shorter than those set forth in the guidelines, or shorter than those currently in use, provided only that certain standards are met *and that subsequent replacement practices are reasonably consistent with the tax lives claimed.*

While taxpayers may adopt the new depreciation schedules without question by the Internal Revenue Service for a period of three years, the use of the Guidelines will not be accepted thereafter if it clearly appears that "the taxpayer's replacement practices do not conform with the depreciation claimed and are not even showing a trend in that direction" (Jur. St., pp. 6c–7c). The manifest purpose of the three-year grace period is to enable taxpayers to bring their retirement practices into conformity with the Guideline lives without losing the benefits of higher deprecation deductions in the interim. It was anticipated by the Treasury that the taxpayer who seeks the benefit of the new deprecation schedules will in fact be "moving toward a replacement practice consistent with the tax life used" (Jur. St., p. 12c). Neither Congress nor the Treasury intended, we believe, that a taxpayer whose current replacement practices do not warrant the use of the new depreciation schedules, and who has no intention of modifying these practices, should nonetheless claim the higher depreciation deduction during the three-year "honeymoon" period.

The West Virginia Commission apparently failed to take account of the conditional character of the option provided by the Treasury. The Commission did not so much as advert to the question whether the company's experience in retiring plant and equipment

entitled it to use the Guideline lives. Nor did it consider whether, if the Guideline lives were to be utilized, the company should be required to adjust its future retirement practices accordingly. On the contrary, pointing out that "[i]t is not unusual for industrial corporations, as well as public utility corporations, to charge on their books depreciation expense based on rates which are different from the rates permitted and used in computing their income tax liability" (Jur. St., p. 16b), the West Virginia Commission fully approved the depreciation rates currently used by the company on its books—rates which the evidence showed to be consistent with its actual retirement practices. Had the West Virginia Commission been cognizant of the conditional nature of the option offered by the Treasury, it would probably not have concluded that prudent management required United Fuel to claim a depreciation deduction which it would not be able to justify in the future and which was wholly out of line with the book depreciation approved by the Commission for rate-making purposes. At least, we presume, it would not have done so without an explicit discussion of the problem.

The Court need not decide in this proceeding whether a substantial federal question would be presented if, after reconsidering its determination in the light of a proper construction of the Guidelines, the West Virginia Commission were to insist that the Company take advantage of the three-year grace period. At the least, United Fuel would seem entitled to have that determination made on the basis of a correct view of federal law. Nor do we express any

view as to whether the Commission's action might be justified by United Fuel's failure, at the time of the hearing, to indicate whether it intended to utilize the Guideline lives, notwithstanding the company's statement of intention in its amended petition for rehearing. That question has been fully briefed by the parties and is not of concern to the government.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 527

UNITED FUEL GAS COMPANY, *Appellant,*

—against—

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, *Appellee.*

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

BRIEF OPPOSING MOTION TO DISMISS OR AFFIRM AND REPLYING TO MEMORANDUM OF AMICI CURIAE

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March 24, 1964

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IN THE

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OCTOBER TERM, 1963

UNITED FUEL GAS COMPANY, *Appellant,* —*against*— PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, *Appellee.*	No. 527

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

BRIEF OPPOSING MOTION TO DISMISS OR AFFIRM AND REPLYING TO MEMORANDUM OF AMICI CURIAE

This brief is submitted in response both to the motion to dismiss or affirm filed by appellee (Motion) and the memorandum for the United States and the Federal Power Commission (Memorandum). Because the Solicitor General concludes that the Court should review the Guidelines question we turn to it first.

1. *Guidelines.* The Solicitor General concluded that appellant is constitutionally entitled to a rate determination by the West Virginia Commission based on a correct under-

standing of federal law, Section 167 of the Internal Revenue Code and Revenue Procedure 62-21, and that the state agency misapprehended such law. To this recognition of merit, we will only add (by way of reaffirming our position set forth in the jurisdictional statement) that this Court's review should not be limited to the state agency's misapprehension of federal law but should include consideration of the state action in this case as in affirmative conflict with Section 167 and valid administrative regulations promulgated thereunder.

Turning to the Motion, appellee's sole contention is that appellant was tardy in arriving at a decision on the use of Guideline lives and hence cannot be heard to complain now. The Solicitor General expressed no view on this question and it was not discussed in the jurisdictional statement because it was never thought to be at issue. The record makes clear that the majority of the West Virginia Commission in no way based its decision upon the time appellant required to consider the new Guidelines procedures. The present belated contention therefore was not a considered state ground below and, in any event, the following chronology shows that it could not be deemed adequate.

On July 11, 1962, the Guidelines were first published. They constituted a radical revision of existing federal tax regulations as to lives of depreciable property (embodied in the old "Bulletin F" under the Internal Revenue Code of 1939). This publication was of enormous significance to American business. The official release of the Office of Tax Analysis of the Office of the Secretary of Treasury made emphatically clear that substantial study would be required:

> ". . . The Revenue Procedure requires each business to justify its depreciation claims by a consistent replacement of assets in conformity with the depreciable life by demonstrating through its main-

> tenance of an appropriate depreciation reserve against its investment that its replacement of equipment corresponds to the depreciable life claimed."*

The Guidelines regulations were extremely complex and recognized that extensive study by taxpayers would be required. The basic publication was thirty-five printed pages and had annexed to it six pages of "illustrative" tables of reserve ratios, etc., and forty-two questions and answers. Commissioner Caplin's concurrent statement said that the Internal Revenue Service "is planning a series of training programs to familiarize tax agents with this new tool" and that at "a later date it is expected that seminars will be held for representatives of industry in our regional and district offices" (R-517). The original Guidelines publication portended the subsequent publication of a series of highly complicated tables and formulae to determine whether a taxpayer's retirement practices justified its use of the shorter lives suggested.

Not until September 17, 1962, over two weeks after the conclusion of the testimonial hearing below, were the actuarial tables and formulae necessary to evaluate Guidelines published (IRS Publication No. 457). That publication contains sixteen pages of fine print tables relating to reserve ratios, rate of growth conversions and adjustments for class lives. It has three pages of related algebraic formulas.

It was another eleven days, or September 28, 1962, before the Treasury published Internal Revenue Bulletin 1962-40 containing additional questions and answers (43 through 59) in respect of Guidelines. These disclosed for the first time important aspects of the interplay of Guideline lives with accelerated depreciation (*e.g.*, questions 44

*This official accompanying release did not even advert to the three-year so called "honeymoon" aspect of the publication, seized upon by the West Virginia Commission to lower appellant's local retail rates.

and 58), the relationship between use of Guideline lives and claimed salvage values (question 45) and some special aspects of Guideline lives vis-a-vis appellant's gas production properties (question 47), etc.*

Guidelines, of course, were not included in the stipulated issues at the prehearing conference below, which took place on June 27, 1962, prior to their publication (J. S. 3b, 4b). Indeed, the West Virginia Commission's staff stipulated at the conference that it would accept as appellant's federal income tax allowance for rate purposes the "actual taxes paid" (R. 58). At the hearing, August 27-30, there was evidence (however impromptu) on the subject of Guidelines, *viz.*, that:

> (a) appellant commenced studying the then available Guidelines materials immediately after their promulgation (the preceding month) and, under the terms thereof, had until the summer of 1963 to determine how it would file its federal income tax return for 1962;
>
> (b) appellant's tentative conclusion was that, since the propriety of the use of Guideline lives depends on replacement and retirement patterns, notwithstanding the "honeymoon", appellant should not shorten the useful lives employed for tax purposes unless such shortened lives would be consistent with existing retirement practices or unless it intended to accelerate retirements to achieve such consistency (R. 1289-90, 1292-95).

As the Solicitor General has noted, other undisputed evidence of record, accepted by the Commission in its findings, showed that (i) appellant's book depreciation rates (including the useful lives on which they were predicated) were identical with the rates (and useful lives) which it

*Subsequently, many additional "questions and answers" were issued to supplement and clarify the materials referred to above.

used for federal income tax purposes and (ii) those rates were properly used to determine depreciation expense for purposes of the retail cost of service (*i.e.*, they reflected the physical facts of depreciation and retirement which constitute the controlling federal criteria as to the use of Guidelines) (J. S. 16b).

Needless to say, appellant was not aware that its rights would later be claimed to have been forfeited because of its failure to formulate and communicate its final negative conclusions in respect of Guideline lives before the West Virginia Commission rendered its adverse decision on the requested rate increase on October 17, 1962. That order simply said that anyone could use the "honeymoon", that appellant had a duty under state law to do so and that its rates would presume that it fulfilled that duty (J. S. 15b-16b). In its amended petition for rehearing, appellant advised the Commission that it had by then definitely concluded that it could not properly, and would not, use Guideline lives (R. 137a, 149a-17). This amended petition was timely and set forth in detail the reasons in support of appellant's conclusion. It unequivocally advised the West Virginia Commission that appellant would not collect any phantom taxes if its retail rates were based on actual tax depreciation practice.* In denying rehearing, the majority of the Commission, in face of the plain fact that appellant's amended petition added significantly to the original record, found that "the matters alleged in said petitions were fully considered by the Commission before entry of

*The suggestion in the Motion that the West Virginia Commission had to avoid a possible boon to appellant resulting from the latter's claiming Guideline lives for federal income tax purposes after its retail rates had been fixed is frivolous. Sections 2554-5 of the West Virginia Code of 1961 (Michie's) empower the Commission to initiate rate reduction proceedings on its own motion and this power certainly can be exercised swiftly and effectively to avoid any recoupment of "phantom" taxes from the West Virginia consumers.

its said order of October 17, 1962" (J. S. 36b). Since the tax decision communicated in the amended petition for rehearing was entirely new and could not possibly have been considered at the hearing, it must be presumed that the Commission considered it immaterial to its original order and its final order that (i) appellant would not, in fact, use Guideline lives and (ii) *a fortiori*, that it had not, at the time of the hearing, made up its mind whether it would.

In light of the foregoing chronology and the terms of the order denying rehearing, the decision below simply could not have been based on the inability of appellant's witness at the August 27-30, 1962 hearings firmly to commit appellant against the use of Guideline lives on its federal income tax returns. Indeed, where federal law (the Guidelines) admonishes careful and complicated studies as a prelude to a taxpayer decision in respect of its federal income tax return, the taxpayer's insistence on completing such studies prior to making its decision (within a reasonable time) plainly cannot be, *as a matter of federal law*, an adequate state ground for decision.

The decision below was plainly based on the misapprehension of federal law referred to in the Memorandum of the Solicitor General *and* on the assumption that West Virginia Commission was free (*i.e.*, not constitutionally precluded by Section 167 and the regulations thereunder) to apply its own criteria to control appellant's federal tax decision, apparently on the theory that a utility management must take advantage of available cost economies for the benefit of consumers.

It is also plain that the West Virginia Commission did more than misapprehend federal law. The Commission *acted* under a misapprehension which had no support in the record and fixed a rate which would either *coerce* appellant into claiming an improper federal income tax deduction or

penalize it for not doing so. Congress certainly did not intend that the West Virginia Commission should be permitted to thwart federal fiscal objectives by indirection. The Constitution precludes any such effort by that Commission and protects appellant from the impact of that effort. It is submitted that the propriety of this state action should now be fully examined and resolved by the Court.

2. *Cost Apportionment.* (a) In response to appellant's extensive argument under the Natural Gas Act and the Supremacy Clause, the FPC staff* rested its argument on a truism, with which no one disagrees, embellished by "illustrations" which are either invalid or miss the point.

The truism is that the Natural Gas Act gave the Federal Power Commission jurisdiction to fix rates for interstate wholesale sales and left to the states jurisdiction to fix retail rates. While true, this is no help in solving a problem which relates to the apportionment of an admittedly indivisible "joint cost" between interstate and intrastate jurisdictions.**

The FPC staff's "illustrations" are no more helpful than the truism. *Of course* a state commission may use

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*We feel justified in attributing to the FPC staff the Natural Gas Act computations and argument in this section, not only because of their content but because of factual opinions expressed on regulatory matters *dehors* the record, *e.g.*, on the possibility that Columbia Gulf's costs have declined "as we believe they have" (fn. 7, p. 13). See also letter of correction, dated March 11, 1964, of Howard E. Wahrenbrock, Esq., Solicitor to the Federal Power Commission.

**The West Virginia Commission's allocation of the transportation cost wholly to commodity had no purpose or effect except to reduce the amount of West Virginia's cost responsibility. It had no intrastate purpose or effect because West Virginia retail rates, unlike FPC wholesale rates, are not two-part rates—the retail rates do not have demand and commodity components. Such statements as that

a rate of return in fixing retail rates different from that used by the Federal Power Commission in fixing wholesale rates. There is not even a theoretical "disparity" in such a case (let alone a constitutional question) because, all other things being equal, the proper rate of return for a retail business may well differ from that for a wholesale business. And *of course* a state commission, in determining retail rates subject to its jurisdiction, may use a rate base method which differs from that used by the Federal Power Commission. Rate base, with rate of return, is one of the basic determinants of the dollar amount of *earnings* to which a utility company is entitled over and above its recovery of *out-of-pocket costs*. These illustrations are in no sense like the problem here.

Even the FPC staff's mathematical analysis of the matter of "confiscation" reflects its blindness to the central problem of this case. The staff (Memorandum, pp. 13-14) calculates that appellant's inability to recoup, between its FPC rates and its West Virginia retail rates, about 800,000 dollars of charges lawfully paid to Columbia Gulf will only reduce its presumed over-all rate of return (interstate and intrastate) to 6.2 per cent. Since a mixed inter-intrastate utility is entitled to a fair return on its intrastate rate base from its retail rates (and a state served at retail can not "free load" on the utility's interstate business and customers in other states), the staff calculation should have been on a West Virginia retail basis only. On such basis, the 800,000 dollar out-of-pocket loss would reduce ap-

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of the staff (Memorandum, p. 9) that "Nothing in the federal statute directs a State agency how to make cost allocations on matters within its jurisdiction", while true, simply miss the point. The question here is what part of the joint cost *is* within federal and what part *is* within state jurisdiction.

pellant's West Virginia rate of return from 6 per cent to about 4.9 per cent.*

In *United Fuel Gas Company*, 29 F. P. C. 90, 95, 97 (1963), the Federal Power Commission, in approving acquisition by appellant of a small affiliated West Virginia retail company, perceived what its staff here seems unable to perceive. The federal agency itself recognized West Virginia's chronic and deliberate refusal to pay its federally determined share of the interstate costs incurred in serving its consumers and the resulting conflict with federal regulation when it said:

> "... The chief reason advanced by applicants for the proposed merger is that Amere, in the regulation of its retail operations by the West Virginia Public Service Commission, consistently has been unable to recover the full cost of gas purchased from Atlantic [full, federally determined, costs of its interstate gas supplies furnished by Atlantic, another affiliate]. Applicants recount, in their brief, the rate problems arising from differences between the rate requirements of this Commission and those of the State agency [the latter's refusal to accept federally determined costs]. These problems need not be detailed here other than *to acknowledge that, for many years, the West Virginia Commission has permitted Amere to include in its cost of service only a portion of the*

*Another disturbing implication in the staff analysis of the impact of the state action below on appellant is found in footnote 7 on page 13 of the Memorandum, *viz.*, that the legitimacy of West Virginia's action, which purports to have been based on the record in this case and which should be justifiable only in terms of that record, should be viewed by this Court on the basis of the staff's beliefs as to subsequent events. The footnote suggests that appellant's Columbia Gulf charges have decreased, but it does not advert to possible offsetting or more than offsetting increases in other costs legitimately incurred. In fact, the dollar gap resulting from the present regulatory conflict increases each year as the Columbia Gulf facilities are expanded annually to meet growing market requirements. That gap currently runs over $1,000,000 annually.

> *actual rates charged by Atlantic, even though such rates had been approved by this Commission. . . .*
>
> ". . .
>
> ". . . Moreover such merger, by eliminating differences as to rate requirements between the Public Service Commission of West Virginia and the Federal Power Commission, will resolve *a longstanding conflict between State and Federal regulation*, thereby advancing one of the fundamental purposes of the Natural Gas Act, namely, to effectuate a coordinated system of State and Federal regulation, each complementing the other." (Emphasis and bracketed materials supplied.)

It seems clear that the truism and the inept illustrations on which the FPC staff relies in the Memorandum are of no help in the present case because the subject matter at issue is the apportionment of a *joint* cost—the cost which appellant incurs to have its gas transported from the Southwest to West Virginia. This Southwest gas cannot be physically segregated into two streams, one which appellant will sell ultimately to its interstate wholesale customers and one which it will sell to West Virginia retail customers. The cost of that transportation therefore cannot be segregated and separate cost tags attached to the MCF's destined for interstate sale and those destined for West Virginia retail sale. Here, a state commission has disallowed an actual and undisputed out-of-pocket operating expense which the Federal Power Commission, as delegate of the legislative Power of Congress, has already determined is just and reasonable and has already determined is to be recouped solely from the intrastate business. A fifty-fifty allocation of a single integral expense item as opposed to a sixty-forty, ninety-ten, or one hundred-zero allocation of the same integral expense item are not merely "disparities" in method; they are in obvious conflict.

The brief of the FPC staff, in its Supremacy Clause discussion, devotes not a word to *Northern Natural Gas Co. v. Kansas Commission* 372 U. S. 84.* In light of the agreement on all sides as to the basic facts, it seems clear that whether *Northern Gas* governs the present case presents a substantial federal question. In each case the state order dealt with a matter normally within its proper sphere of jurisdiction. In each the state order directly affected a natural gas company engaged in interstate commerce. In each an alternative course of action was available to the company which involved only dollars—Northern, through assumption of the extra "take or pay" costs of the Republic "A" contract which compliance with the state order would impose upon it (750,269 dollars, Memorandum for the Federal Power Commission in No. 62 October Term, 1962, p. 30); appellant, through assumption of the difference left between the aggregate of the state and federal allocations of transportation expense and the total expense which by federal law must be paid (approximately 800,000 dollars).**

In each case the exaction could be passed on to interstate purchasers (rather than investors in interstate pipelines) if the Federal Power Commission were willing to do so. In each case, if the FPC be unwilling (as it is in this case)

*There is instead a brief reference in the discussion of the possible burden on interstate commerce, notwithstanding that the whole thrust of the opinion in *Northern Gas* is bottomed on the Supremacy Clause and federal preemption. Curiously (or perhaps significantly) the staff, in its Memorandum to this Court in *Northern Gas* (No. 62 Oct. Term 1962, p. 23) said that the "essence" of its contention there was that the Kansas action would "impose burdens, in the form of increased rates, upon consumers in other States."

**As to the FPC staff's suggestion that the $800,000 figure may not be accurate because of developments subsequent to the close of the record, it is certain that, apart from the dubious nature of such an approach, the constitutional question would be the same if the figure were halved or quartered.

to permit recoupment from interstate customers, the interplay of state and federal regulations will impose a burden on the pipeline investors and the company management will tend to pervert its operations to avoid the loss. Northern would tend to juggle its purchases as among Kansas, Oklahoma and Texas to minimize the impact of the Kansas proration order and appellant would tend to decline to expand service from the Southwest through the Columbia Gulf line. If anything, the present federal-state jurisdictional conflict over cost responsibility is far more grave than the conflict over purchases involved in *Northern Gas*.

In passing the Natural Gas Act "Congress contemplated a harmonious, dual system of regulation of the natural gas industry. . . ." See *Public Utilities Commission* v. *United Fuel Gas Co.*, 317 U. S. 456, 467. As the Court said in *Northern Gas*:

> ". . . Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously *impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other states.* This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority. . . .
>
> "It may be true, as the State Commission urges, that accommodation on the part of the Federal Power Commission could avoid direct collision—but this argument misses the point. Not the federal but the state regulation must be subordinated, when Congress has so plainly occupied the regulatory field. . . ." (372 U. S. at 92-93; emphasis added.)

The essence of the Supremacy Clause is that state policy must give way to federal policy where the latter has been

validly established by Congress. As a result, West Virginia is indisputably not free to interfere either with appellant's wholesale rates or with its interstate facility and gas procurement programs (all of which have been certificated by the Federal Power Commission under Section 7 of the Act). While West Virginia is free to implement its legitimate local retail rate policies, it is not free to adopt a local policy which attempts (and in the past has succeeded) to avoid payment of its share of regulated *interstate* costs, leaving consumers in other states to do so. (We emphasize "*interstate*" costs because the Columbia Gulf costs are clearly and solely such.)

"Free loading" on appellant and its consumers in the other states which it serves at wholesale is a correct characterization of the West Virginia policy embodied in the decision below. The Motion discloses the underlying state policy by its strong emphasis on "West Virginia gas for West Virginians". The Motion points out as significant that, while 80 per cent of appellant's pooled gas supply in the Appalachian area comes from the Southwest, "it is still true that it purchases and produces more gas in West Virginia than it sells to West Virginia customers" and "that the West Virginia customer is charged as though 80 per cent of the gas came from the Southwest" (pp. 2-3). West Virginia also puts forth as relevant that "some of United Fuel's West Virginia's customers sitting virtually on top of a gas well pay for their gas as though 80 per cent of it came from the Southwest" (p. 3). This plainly is an *improper* ground for West Virginia's dissent from federal policy, because the entire concept of appellant's interstate system has been approved, step by step as it was constructed, by the Federal Power Commission under Section 7 of the Natural Gas Act as being in the public interest.

West Virginia has no *proper* ground whatever for its dissent from, and conflict with, federal policy:

(a) its demand-commodity classification is not made for any exclusively local purpose within its intrastate jurisdiction; as noted earlier, that classification does not enter into the design of retail rates since they do not have demand and commodity components; its only purpose and effect is, conflicting with the federal allocation, to free West Virginia of a federally determined proper share of the costs of rendering service;*

(b) its refusal to apply the *"Seaboard"*** fifty-fifty allocation of the Columbia Gulf transmission cost is inconsistent with its own use of the *Seaboard* fifty-fifty allocation for costs associated with appellant's transmission system; the Columbia Gulf line is, physically, nothing more than an extension to the Southwest production fields of appellant's transmission system;

(c) its refusal to apply the *Seaboard* fifty-fifty allocation to the Columbia Gulf transmission cost is contrary to the position of the intervening West Virginia cities below, all of which supported use of the *Seaboard* formula for the Columbia Gulf transmission cost.

If West Virginia is free to use a "cost classification" technique to decline to pay 800,000 dollars of appellant's Columbia Gulf transmission costs, why can it not so "class-

*The Federal Power Commission makes the demand and commodity allocation of total costs for two purposes: *First*, to apportion joint costs between intrastate retail and interstate wholesale responsibilities; *second*, to apply the demand-commodity allocation to the interstate wholesale portion so determined in order to design the interstate wholesale rates, as a method of distributing interstate costs among the various interstate wholesale customers. West Virginia uses the demand-commodity allocation *only* for the first purpose (and in so doing directly conflicts with the FPC apportionment).

**Atlantic Seaboard Corporation, 11 F. P. C. 43 (1952), discussed *infra*.

ify" and "allocate" all appellant's other interstate costs in a similar manner? Must West Virginia's implementation of its local policies become that naked and that extreme before federal policy is offended?

All the foregoing facts and considerations can also be articulated as raising substantial questions under the Commerce Clause and the Due Process Clause. Reading the Constitution as an organic whole it seems fundamental that the federal system it created was not intended to, and should not be permitted to, countenance the admitted results in this case. Appellant's cost recoupment from its interstate customers is limited by valid federal regulation and West Virginia's deliberate refusal to permit recoupment of the federally determined balance from local customers violates basic principles of common everyday justice. Neither the authors of the the Constitution nor the Congress in enacting the Natural Gas Act could have intended such a result as the price of federalism.

(b) The West Virginia Commission recognizes the impropriety of conflicting federal-state cost allocations when it says (Motion, p. 8) that, of course, it "would not agree to one method of classification before the Federal Power Commission while adopting another for the same company in West Virginia". However, it claims that it is constitutionally free to fix a rate based on a conflicting allocation because appellant's FPC rates were approved by the Federal Power Commission, not after litigation and adjudication, but as a result of a settlement which was expressed to be "without prejudice" to the claims or contentions of any party.

That position ignores the fact that an interstate rate filed or fixed by the Federal Power Commission under the Natural Gas Act (and whether resulting from adjudication or settlement) becomes the legal rate and the only rate which can be charged or paid. That rate, in this case, by its de-

sign and its dollar levels, intends that appellant recoup only eighty-nine and one-half cents out of every dollar it pays to Columbia Gulf for transmission of Southwest gas to the Appalachian area and it requires that West Virginia permit appellant to recoup the remaining ten and one-half cents (not merely eight cents) of that dollar of out-of-pocket cost. In our view these are the controlling constitutional facts.

It would be a gross injustice for appellant's constitutional rights in this case to depend on the fortuity that, technically, the Federal Power Commission allocation disputed by West Virginia was embodied in a rate settlement. The character of federal law with which appellant's federal rates are endowed has, as to this matter of fifty-fifty classification of a transmission cost, much deeper roots than merely the proceeding in which these *particular* rates were approved. The Federal Power Commission has enforced, on an industry-wide basis, the fifty-fifty classification of transmission costs ever since its adoption of the so-called "Seaboard formula" in 1952, in *Atlantic Seaboard Corporation*, 11 F. P. C. 43. *Seaboard* held that a transmission cost, even though a fixed or capacity cost which did not vary with volume of service, should nevertheless be classified fifty per cent. to demand and fifty per cent. to commodity. The *Seaboard* formula has ever since remained a cornerstone in Federal Power Commission determinations of interstate natural gas rates.*

*For example, the Federal Power Commission recently said, in ruling that a lateral line to a production field should be treated (for purposes of cost classification) as a transmission line:

> "The Laverne Field lateral is 40 miles long, has a diameter of 20 inches, has a capacity of 200,000 Mcf of gas per day, is connected to the company's main line, and is in substance an extension of the main line. On these facts, this facility reasonably should be viewed as a transmission facility and the costs associated therewith treated as transmission costs, to be classified in conformity with *Seaboard* 50 percent to de-

With that background and with the Federal Power Commission's national application of the *Seaboard* formula, no other classification of the transmission costs in question in an FPC approved settlement was conceivable.*

Nor does the language in the FPC orders approving appellant's settlement rates, quoted in full in the Motion (pp. 7, 8), support the position of the West

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mand and 50 percent to commodity." American Louisiana Pipe Line Company and Michigan Wisconsin Pipe Line Company, 29 F. P. C. 932, 943 (1963).

Federal Power Commission decisions over the past twelve years to the same or similar effects are legion; *e.g.*, Northern Natural Gas Company, 11 F. P. C. 123 (1952); Panhandle Eastern Pipeline Company, et al., 13 F. P. C. 53 (1954); El Paso Natural Gas Company, 13 F. P. C. 421 (1954); Transcontinental Gas Pipe Line Corporation, 20 F. P. C. 843 (1958); El Paso Natural Gas Company, 22 F. P. C. 260 (1959); Kansas-Nebraska Natural Gas Company, Inc., 25 F. P. C. 448 (1961); Kentucky Gas Transmission Corporation, 26 F. P. C. 795 (1961); and Southern Natural Gas Company, 29 F. P. C. 323 (1963).

*We omit extended discussion of what effect the West Virginia Commission's contention if upheld could have upon the Federal Power Commission's comprehensive program of arriving at interstate rates by settlement procedure. This Court is familiar with the tremendous backlog of undecided cases which had accumulated on the FPC docket and of the chaotic state which layer upon layer of undecided FPC rate cases had produced in the natural gas industry. In the settlement procedure the "without prejudice" clause is a standard provision of Commission orders. That procedure has been the means by which the Commission has very substantially reduced its accumulated backlog.

A very large number of rates in the present interstate natural gas rate structure are based on settlement agreements containing the "without prejudice" provision. For example, in its annual report to Congress for the year 1961, the Federal Power Commission reported that of thirty-one rate increase applications disposed of during fiscal 1961, thirty were completed through conference procedure (p. 77). The 1962 report (p. 83) pointed out the important advantages derived from the settlement procedure and the 1963 report (p. 122) noted that most of the rate cases disposed of that year were settlements. We do not attempt to assay what would be the effect if it were held that none of this substantial part of the interstate natural gas rate structure had the force of federal law.

Virginia Commission. In the first place, we do not believe it is possible for a party (including a state regulatory agency) effectively to reserve a right to disregard federal law (or, in the case of a state agency, to enter a local order, affecting an interstate natural gas company, which conflicts with federal law). Secondly, we do not believe that such language purported to reserve to the state agency a right to do what it did. No doubt this language left the West Virginia Commission free, as it left all other parties to the federal agency proceedings free, of any estoppel by reason of the settlement or the order. The West Virginia Commission was free, as were all other parties, to assert in the future (whether or not there was any change in circumstances) that a different procedure should be used and a different result reached in any future proceeding. But that is not freedom to any party, sovereign state or private corporation, to disregard the federal rate or rate structure, nor freedom to West Virginia to attack it collaterally by an order of its Public Service Commission.

CONCLUSION

The motion to dismiss or affirm should be denied and this Court should note probable jurisdiction in respect of both questions presented.

Respectfully submitted,

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